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HOT OFF THE PRESS!

Summer laziness?

With Brexit now finally behind us it's time to re-visit the proposed hedge strategy in April in EURUSD for the people that expected the exit to happen. The then shown putspread, which expires in October, has so far returned a positive 18% on the spent premium. I think it makes sense to stick to that position.

Otherwise, are markets getting to complacent this summer?

Seems Brexit didn't happen if one looks at the major indices, volatilities and sentiment... of course apart from the British Pound, which is still much weaker than on June 23.

Don't forget, we have troubled Italian Banks, Greece woes flaring up every now and then, we have uncertain US elections ahead of us, Turkey/Russia and Western disagreements, and lastly have reached unchartered territory in all the Central Bank (policy) world with asset prices feeling very rich.

Topics of this edition:

1. Trade idea - long Gold versus Euro
2. Trade idea – short CAD versus USD
3. A quick recap of previous ideas

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1. Trade idea - long Gold versus Euro

One trade to consider is to be long Gold versus Euro for the upcoming months.
Yes, it has rallied 20% since January. However, Gold has now retraced a little from its recent highs around the Brexit vote, and volatilities have stabilized on lower levels. Though despite the overall positive market sentiment Gold hasn't given back all the gains and is now hovering around 1200 Euro per 1 ounce of Gold.

Enter into this long Gold position via Callspread - otc or warrant, both feasible	
Long Strike:	1235 Euro
Short Strike:	1350 Euro
Indicative Price:	23 Euro per 1 ounce of Gold
Spot reference:	1200 Euro per 1 ounce of Gold - as of 28 July 2016 -
Maturity:	6 months

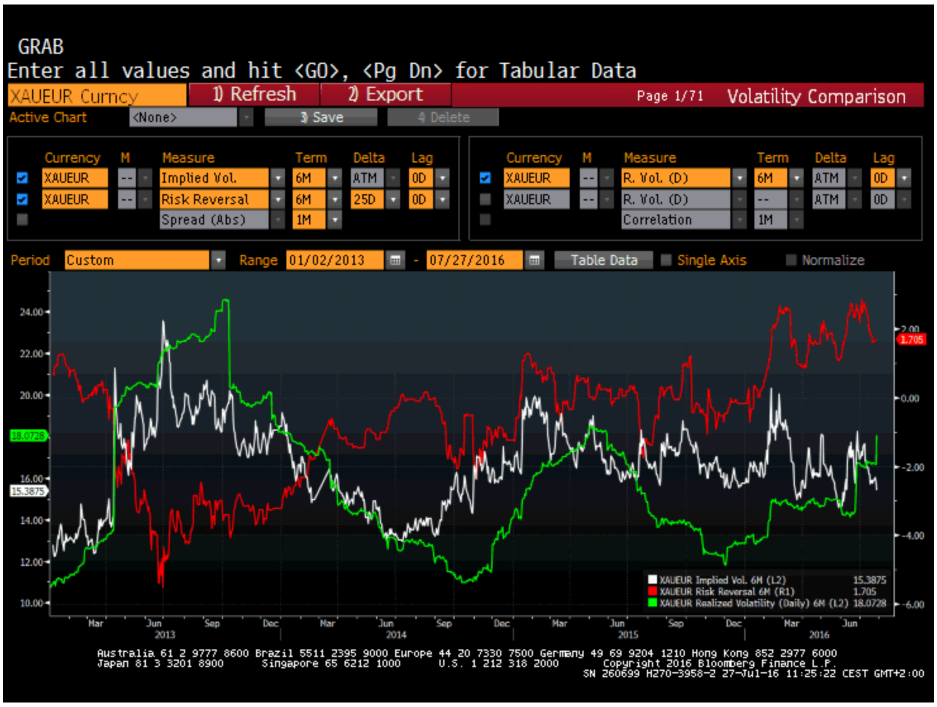
The above Callspread allows you to participate in an increase of the Gold price versus the Euro from 1235 Euro up to 1350 Euro, where the maximum payout is then 115 Euro at maturity (the difference of the Long and Short Strike). Hence the structure offers you a 1:5 payout ratio. The maximum risk to the trade is that the Callspread expires worthless if Gold does not increase in value, in which case the invested premium is lost.

Gold/Euro exchange rate history - past 12 months:

click chart to enlarge

Implied option volatilities are back to more interesting levels, as can be seen in the graph below. In addition, due to market positioning, the absolute volatility levels for Gold Calls with higher Strikes are still elevated compared to at-the-money ones, making a Callspread a decent structure to put on, as you benefit from that higher volatility via the Short Strike which leads to a decent premium reduction.

Gold/Euro option volatilities and skew - expiry 6 months:



Click chart to enlarge

From a fundamental point of view we have seen the strongest inflows into the Gold ETFs for a long time since the beginning of this year, as people were looking for safe haven investments. That actually could also pose a risk to my long Gold idea, should investors all of a sudden reverse these inflows. Another Gold supportive is the general low or negative rate environment, as it makes holding Gold comparably cheap. Investors often cited Gold as not being attractive in the past as it doesn't pay any interest.

Don't get me wrong, I don't expect a hefty correction in the next few weeks. But you want to buy the protection when it feels relatively cheap, not when everyone is running for it.

2. Trade idea – short CAD versus USD

The other trade I like is to be short Canadian Dollars versus preferably the US Dollar.
I make the story shorter here…

Enter into a bearish Canadian Dollar trade versus the US Dollar via Callspread on the USD - otc or warrant, both feasible	
Long Strike:	1.3325 CAD per 1 USD
Short Strike:	1.3825 CAD per 1 USD
Indicative Price:	1% USD notional (ie 10'000 USD for 1mio USD exposure)
Spot reference:	1.3130 CAD per 1 USD - as of 28 July 2016 -
Maturity:	6 months

The above Callspread allows you to participate in an increase of the US Dollar versus the Canadian Dollar from 1.3325 CAD up to 1.3825 CAD, where the maximum payout is then 3.62% USD (ie 36'200 USD for 1mio USD exposure) at maturity. Hence the structure offers you a 1 : 3.62 payout ratio. The maximum risk to the trade is that the Callspread expires worthless if the CAD does not decrease in value, in which case the invested premium is lost.

Why short Canadian Dollar?

- Positioning
  The majority of the market is long CAD which makes me uncomfortable, and the so-called weak side for market participants will be therefore the topside in USDCAD, when investors will rush to the door.

- Correlation
  The USDCAD exchange rate is negatively correlated to the price of Oil. I could imagine Oil has found a medium-term top and may be even correct a little lower, hence dragging CAD with it.

- Economy
  Whilst the majority of analysts don't expect any move by the Bank of Canada (BoC) over the next six months on the rates side I think we could get a surprise from two angles, first from the BoC itself and potentially also from the FED by changing their language to a more upbeat tone. Structural issues in the export sector and weak investment expectations might force the BoC to act.

USD/CAD exchange rate history - past 12 months:

click chart to enlarge

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3. A quick recap of previous ideas

USDJPY
The most recent trade was in upside USDJPY. Timing was very good to enter into the trade and so far the performance is very strong. Termsheet of this trade upon request.

EURNOK
Our bearish EURNOK idea fared well, with EURNOK trading down from around 9.6500 early January, when the trade was opened, to around 9.3500 now at expiry.

USDCHF
On the negative side the bullish USD play versus CHF didn't do well ultimately, even though the timing to enter the position in December was good and the USD gained in value nicely until end of January. As we didn't see the rally over parity resume now in spring & summer the Callspread expired worthless.

NOKSEK
Still open is the long NOK versus SEK relative value investment via 1.00 – 1.045 Callspread expiring in late August. At time of writing NOKSEK spot is trading around 1.0150, hence heading for a good finish.

Contact me
Feel free to speak to me should you have any questions, thoughts or needs around above topics, or any other currency matter that concerns you.

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