

A View from the Trenches

Toronto, Monday, August 17th, 2009

Good morning,

I thought it would be worthwhile to start the week describing how the last one ended. Today's letter will be merely descriptive (vs. the typical analytical format) and full of charts, but I think that sometimes, there is value in induction.

With positive news out of Europe early Friday, it seemed it was going to be a good day across the Atlantic. The surprise came when, suddenly, the 30-yr Treasury rallied in early trading. With this rally, the yield curve was going to have an interesting flattening move by the end of the week (see charts below). However, early in the morning the USD was not appreciating, but the EUR/JPY was falling. Why would the USD not rally as well? Someone suggested it was a signal that the USD was becoming "the" carry currency, in line with what had happened to Japan. But if that was the case, we should have seen risk being bid (equities rising overseas, credit tightening), and that did not happen. In the meantime, crude (at around 8am ET) was holding its weight. One could still hope...until it just plunged. Obviously, volatility increased. Where is the inconsistency? As you can see, the 3-mo Libor-OIS spread kept making lower lows (did that liquidity end up in Treasuries?), while sovereign credit default swaps remain extremely cheap. Can this reversal lead us back to March/09 levels, if bad macro news keep coming and the Fed is really not going to monetize any more fiscal debt? I think this is only half of the problem. I think the other half is that the global coordination we saw in 2008 is losing strength in 2009. The Bank of England led the way with its decision to increase its quantitative easing program. Others should follow, but are in denial mode. We should not ignore the VIX index, which is telling us correlation (systemic risk) is still alive.

(Source: Bloomberg)



Martin Sibileau

martin@sibileau.com

(647) 999-2055

Disclaimer: The comments expressed in this publication are my own personal opinions only and do not necessarily reflect the positions or opinions of my employer. I prepared and distributed this publication as an independent activity, outside my regular salaried work. No part of the compensation I receive from my current employer was, is or will be directly or indirectly related to any comments or personal views expressed in this publication. All comments are based upon my current knowledge. You should conduct independent research to verify the validity of any statements made in this publication before basing any decisions upon those statements. The information contained herein is not necessarily complete and its accuracy is not guaranteed. If you are receiving this communication in error, please notify me immediately by electronic mail or telephone. The comments expressed in this publication provide general information only. Neither the information nor any opinion expressed constitutes a solicitation, an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments. The comments expressed in this publication are not intended to provide personal investment advice and they do not take into account the specific investment objectives, financial situation and the particular needs of any specific person. All rights reserved.