Strategy Sweden: On the radar

This publication is a summary of interesting market related topics and observations that have been covered and discussed within the Strategy Research Sweden group, but not necessarily yet formalized in form of a specific view or trading idea…

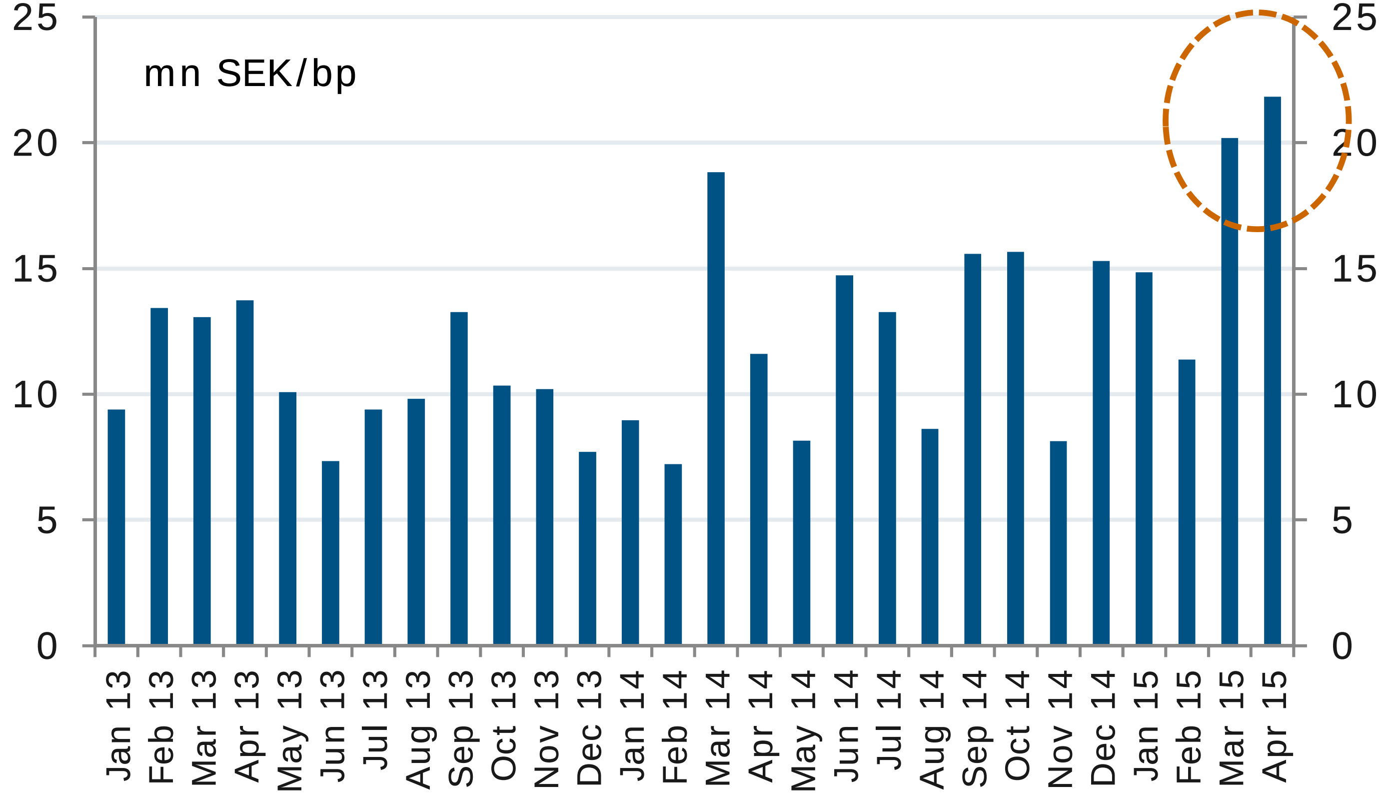
Themes in this edition:

- ***SEK macro****: weekly data on the boiling housing market*
- ***SEK rates****: rollin' on the river of rising yields*
- ***Covereds****: already reflect probability for higher rates*
- ***Swaptions****: exploit high volatility and roll-down*
- ***EUR/SEK****: QE and valuation vs the Riksbank*
- ***EUR:*** *the changed nature of the Euro*

26 May 2015

Markets

Chart of the week: Gross issuance of covereds in risk terms…



…YTD gross issuance of covereds is high, especially if expressed as delta risk

Trades on the radar

Strategy view on direction and curve: *no reversal of MP in sight, rather the opposite given an activist Riksbank. Higher rates 5y+ in the pipeline for H2 on back of improved business cycle and this should keep curve steep. Anchored front-end means put roll-down trades back on the map.*

ASWs – go for flatter ASW curve SGB 1051/1058. Swedish swap curve sticks out as steep relative govies and foreign markets. Sell 1058s, buy 1051s and flatten swap curve in between.

ASWs – extend from SGB 1058 to 1059 vs swaps. The new 10y bond is looking overly cheap on the curve. SGB 1059 should have potential to richen up to 13 bps vs 1058s in ASW terms over the next 6 months.

Swaps – pay belly in 2/5/10y. Given the steep SEK swap curve, curvature should be higher. Pay 5y versus wings.

Swaps – receive SEK 5y5y vs EUR. When yields were on a down trend, the govie curve flattened more than swaps. When yields gapped up, swaps steepened as much as govies. Seems to be some relative value in receiving SEK 5y5y.

FRAs – receive FRA Jun17, pay FRA Mar16, Pay 2y2y. Butterfly with nice roll-down features and a risk-profile that could work on both the up- and downside in rates.

Index-linked – long SGBi 3110, 3102 or 3108 BEI. Break-even has lagged uptick in nominal bond yields and the steepening of the curve.

Covereds – buy 184, pay FRA Dec15. Potential to roll 10 bps vs swaps in next 3 months.

Previous edition (12 May)

Strategy statement on direction and curve: *no reversal of MP in sight, rather the opposite given an activist Riksbank. Higher rates 5y+ and a steeper 5/10y curve in the pipeline for H2 on back of improved business cycle. Still near-term risk for a bond squeeze on back of expanded QE.*

ASWs – go for flatter ASW curve SGB 1051/1058. Swedish swap curve sticks out as steep relative govies and foreign markets. Sell 1058s, buy 1051s and flatten swap curve in between.

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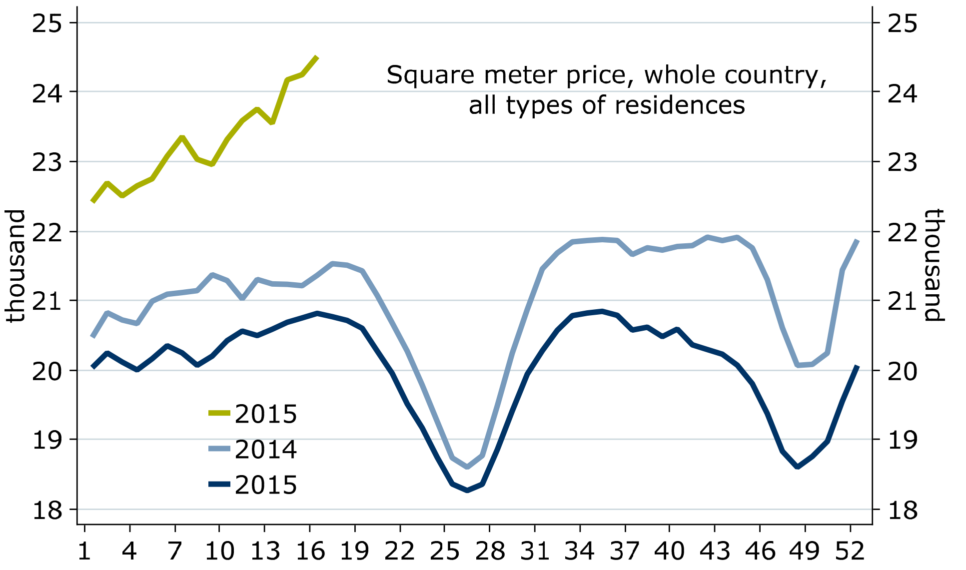
FRAs – receive March or June 2016. Market rates now higher than Riksbank's path, that still contains easing bias. Too early to bet on policy reversal.

Index-linked – long SGBi 3110, 3102 or 3108 BEI. Break-even has lagged uptick in nominal bond yields and the steepening of the curve.

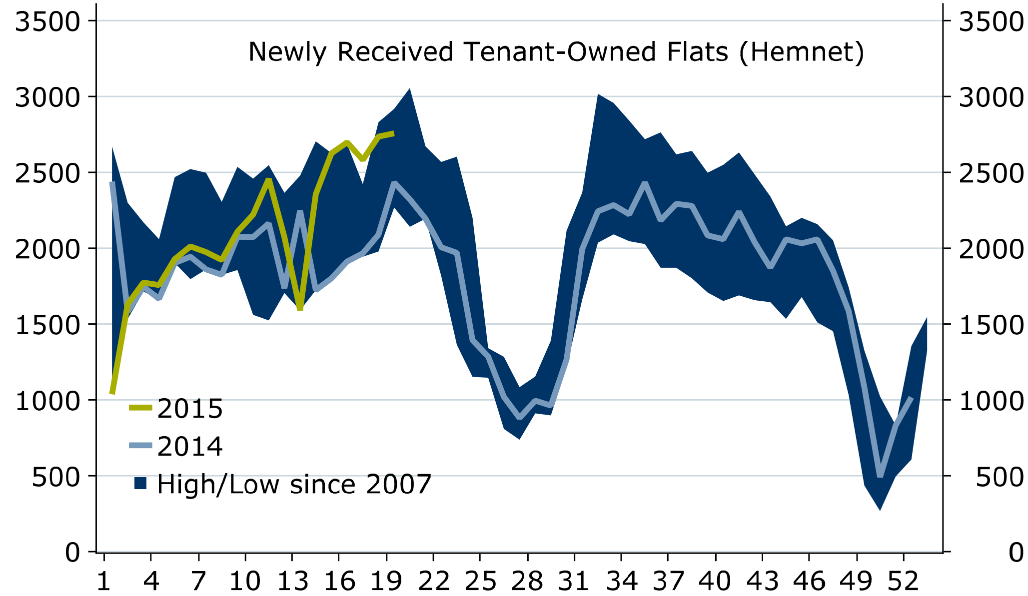
Covereds – over-weight 184, under-weight 5527 & 569. Support from issuer should be reflected in pricing as the June index-extension gets closer.

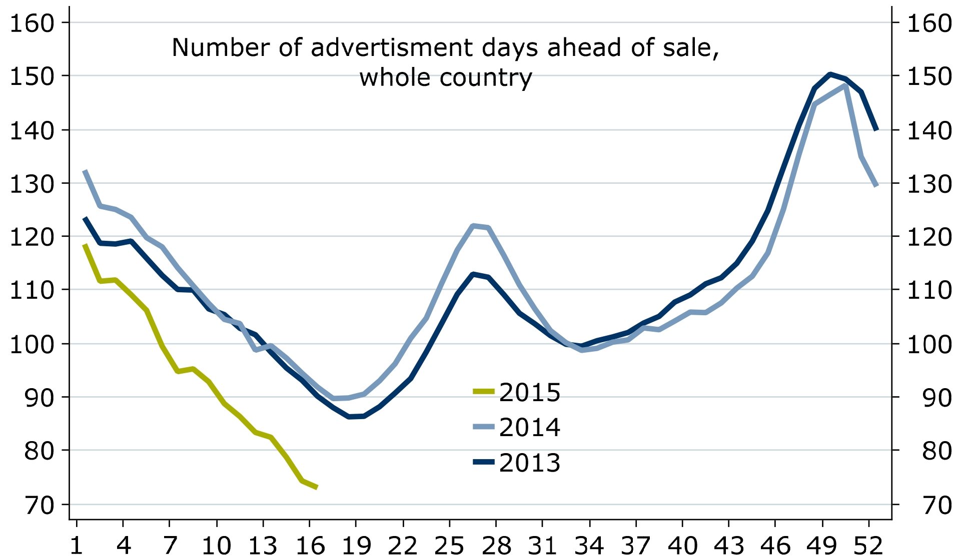
SEK macro: weekly data on the boiling housing market

Negative repo rate has led to an increased activity in housing market, especially outside the most overheated area (Stockholm). Higher prices, shorter lead time to sale, more objects being put up for sale … the heat is on!



Source: Nordea Markets, Booli





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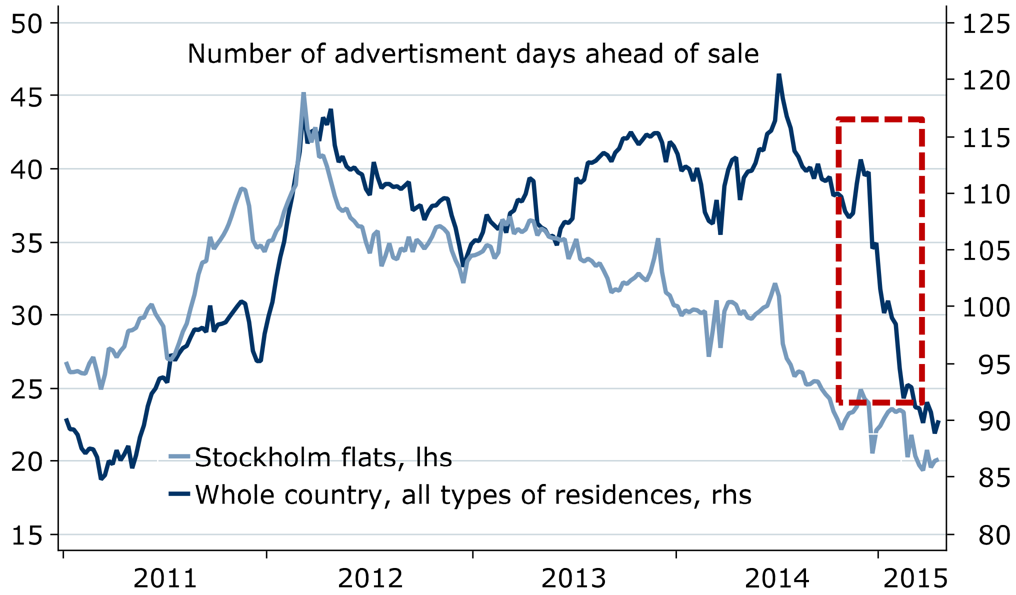
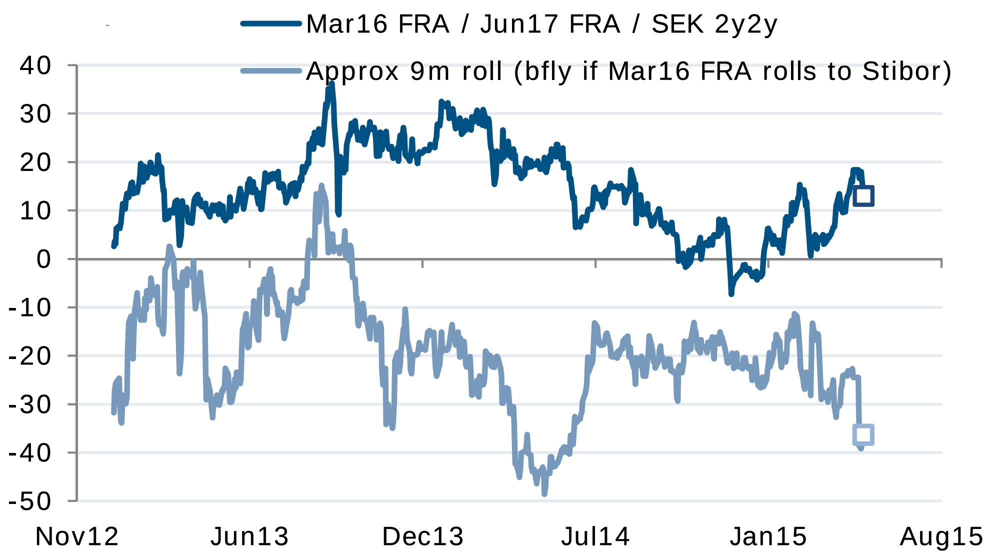


Source: Nordea Markets, Booli

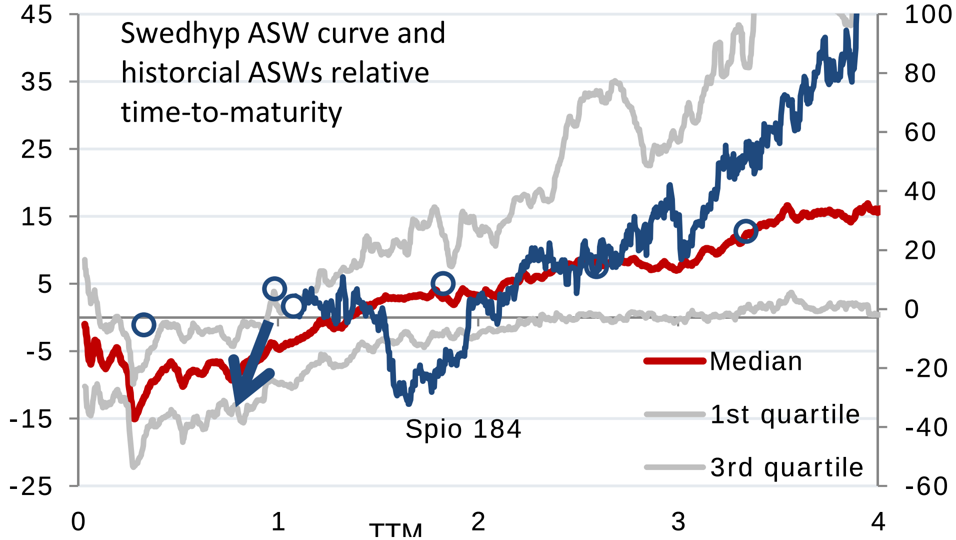
SEK rates: rollin' on the river of rising yields

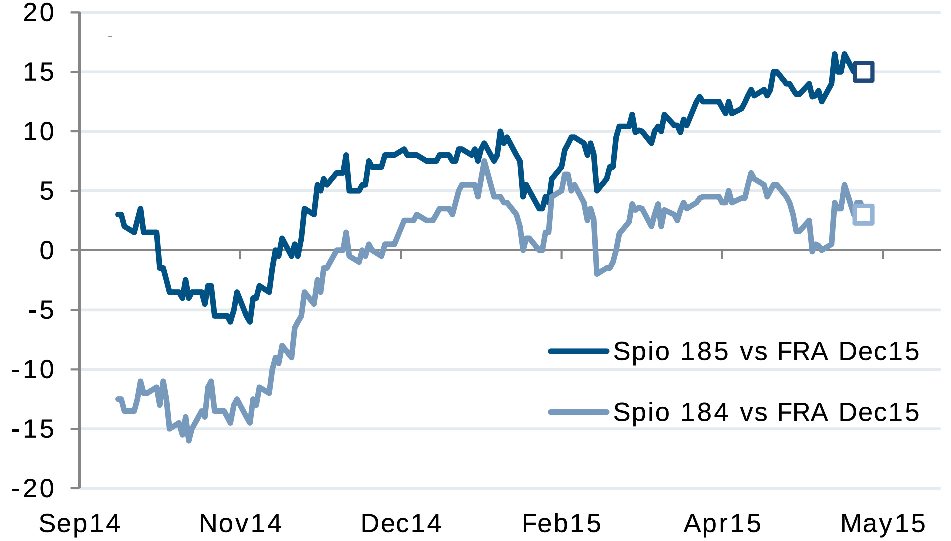
Much lower than expected CPI print opens up possibility of more Riksbank easing. After global gap in yields the upside, SEK market (soaked with excess liquidity) offers decent roll-down in swaps and covereds

Roll trade no 1: receive FRA Jun17,pay FRA Mar16, pay swap 2y2y (b-fly). The 2y-3y looks overly steep, while the front FRA does not roll much negatively. Trade could work on both higher and lower rates.



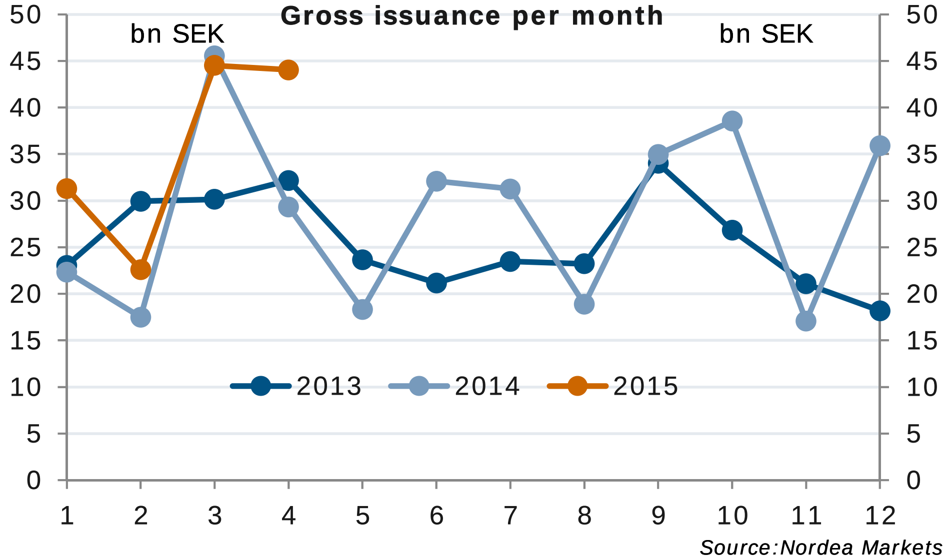
Roll trade no 2: Buy 1-1.5y covered, pay FRA Dec15. 1y covereds cheap running into index-extension in June. For example, Spio 184 has potential richen 10bps to swaps over next 3 months.

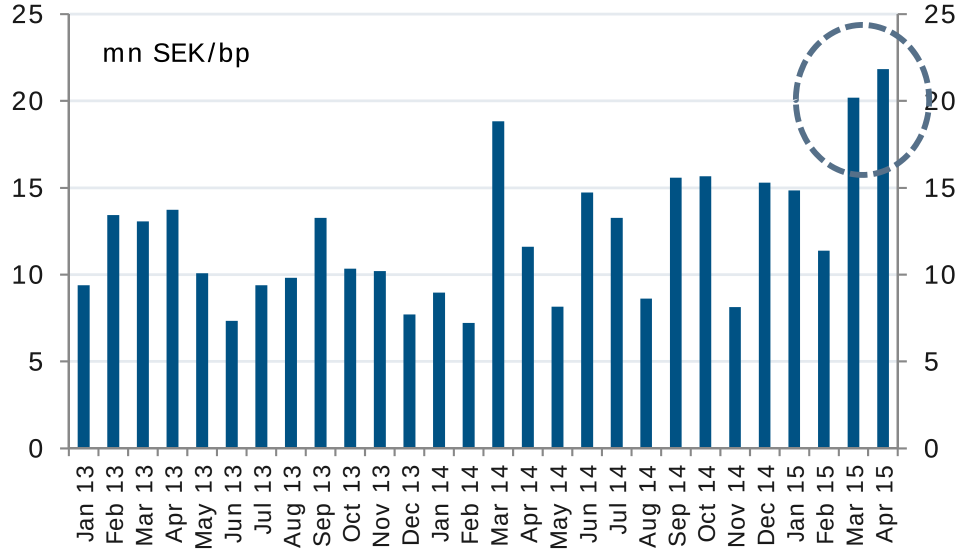


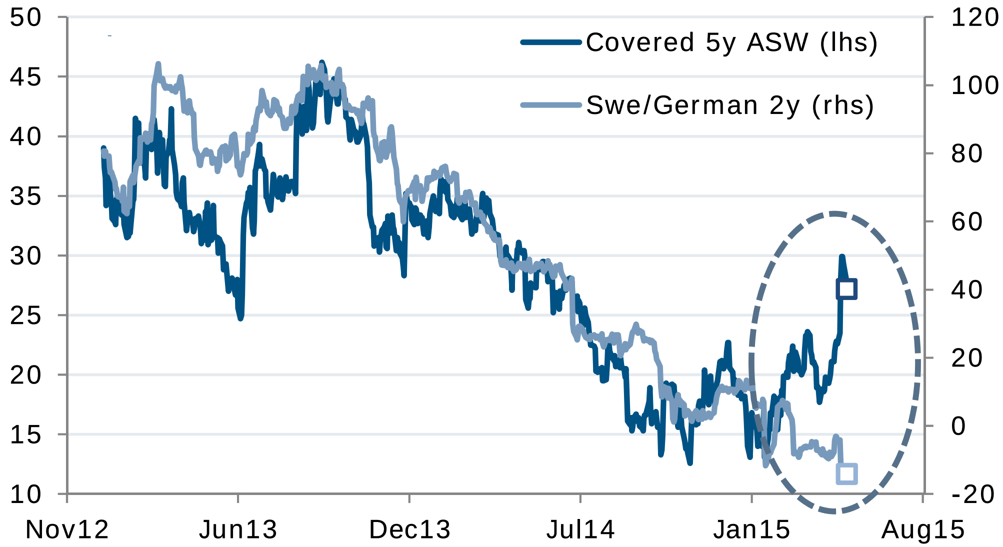


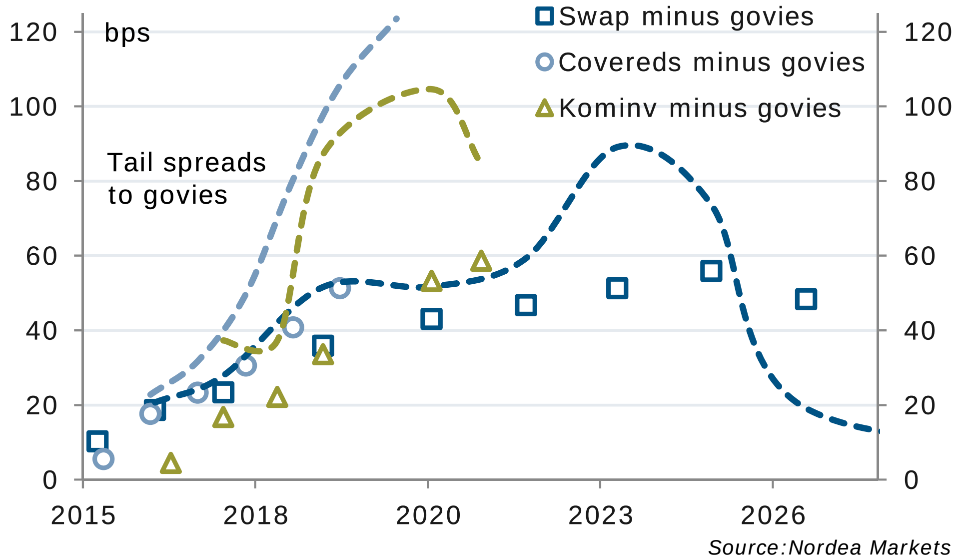
Covereds: already reflect probability for higher rates

Both covered and municipal (Kommuninvest) curve looks steep relative govies & swaps. Issuance in covereds partly behind this. Extending out to ~3-4y make seems like a good value trade for lower rates…

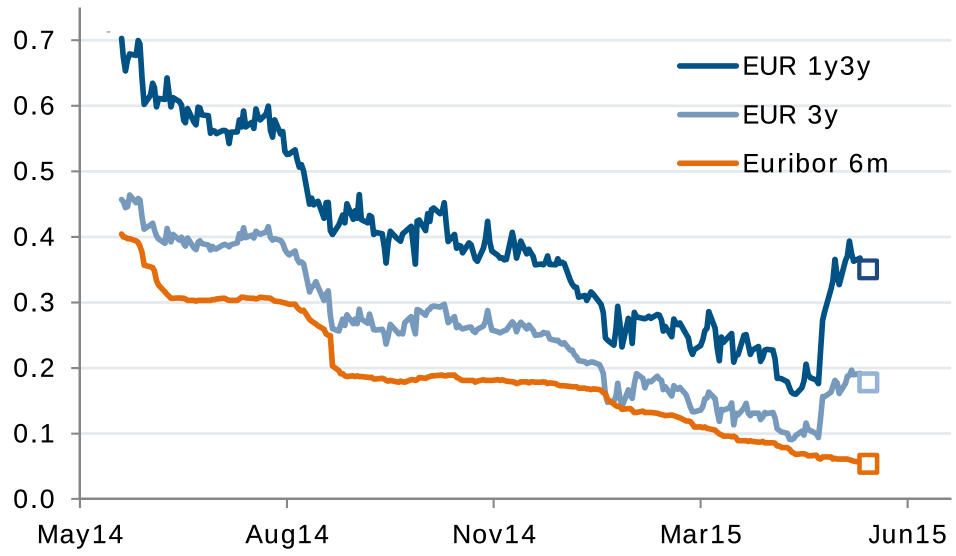


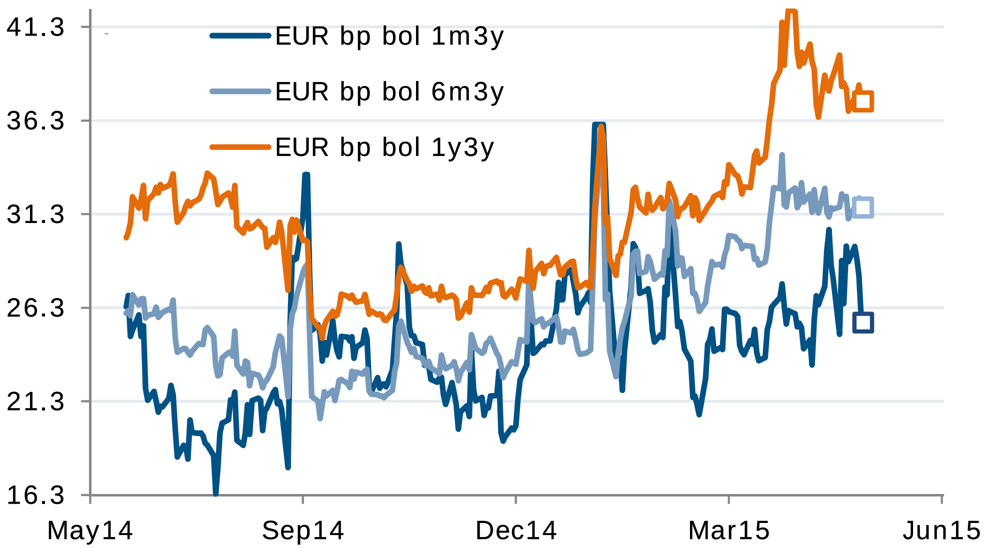






Swaptions: ways to exploit high volatility and roll-down





If you have a bond bearish view and already have some exposure on, there are some interesting ways to hedge if there is a set-back and yields turn back down again.

Volatility will likely fall with lower rates, and given the fierce gap up in yields that we have witnessed recently, one may at least partly be more comfortable with selling out-of-the-money receivers.

Both the SEK and the EUR curve has steep 0-5y curves, and we like the following swaptions structures:

EUR 1y3y: Buy receiver spread 1:1 ~amtf:atmf-20bp. Sell 1 payer k=amtf+20bp

Front-end in EUR should be capped, and high vol creates good entry point.

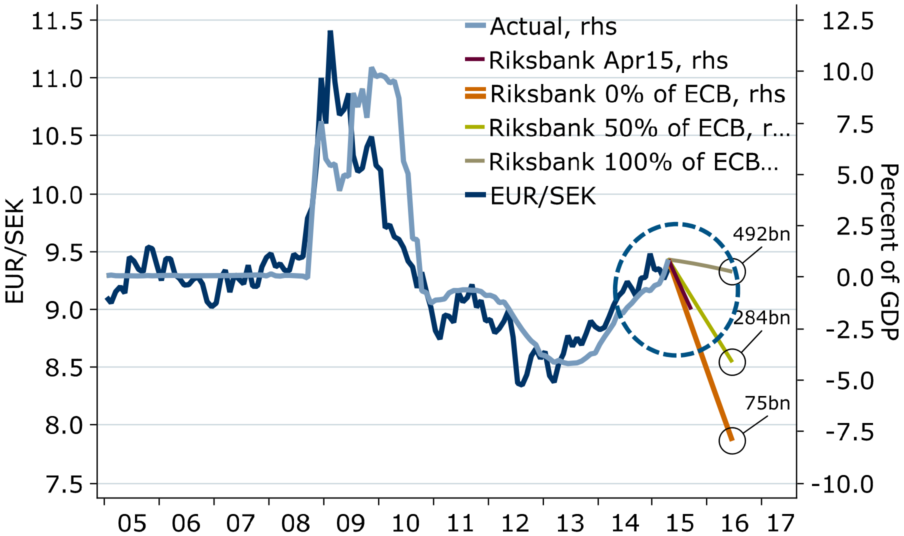
SEK 1y3y: Buy receiver spread 1:1.5 ~amtf:atmf-25bps

Mostly a roll-down trade (1y3y about 43 bps above 3y currently). Due to high vol you get decently paid for sold receiver. Trade starts loosing at rates lower than ~-20 bps … worth keeping in mind, that this trade could make could money even if Rix cut by 25 bps, and Rix is seemingly skeptical to how much into negative territory they can send the repo rate.

EUR/SEK: QE and valuation vs the Riksbank

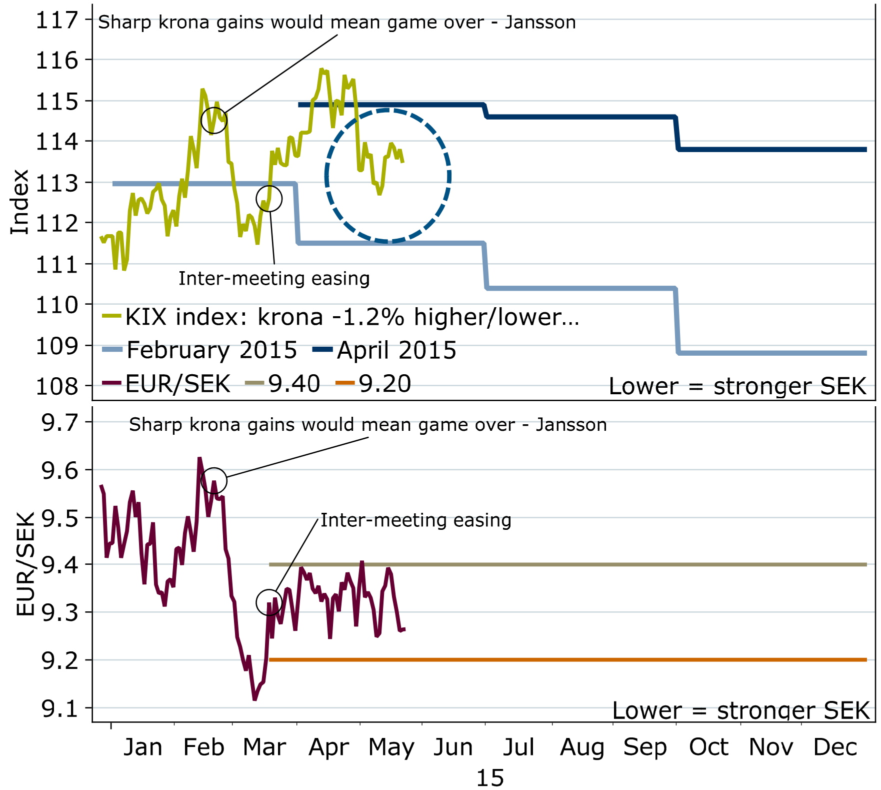
The SEK is too strong given rate spreads. This may be explained by the impact from relative QE, which if true suggests the Riksbank must be almost as aggressive as the ECB to prevent FX strength. Valuation also work in the direction of SEK strength as the currency is 15% weaker than usual. If QE decides, EUR/SEK will be pressured to 9 by September. This will prompt Riksbank action unless USD strengthens.

Sources: Nordea Markets and Macrobond



Sources: Nordea Markets and Macrobond

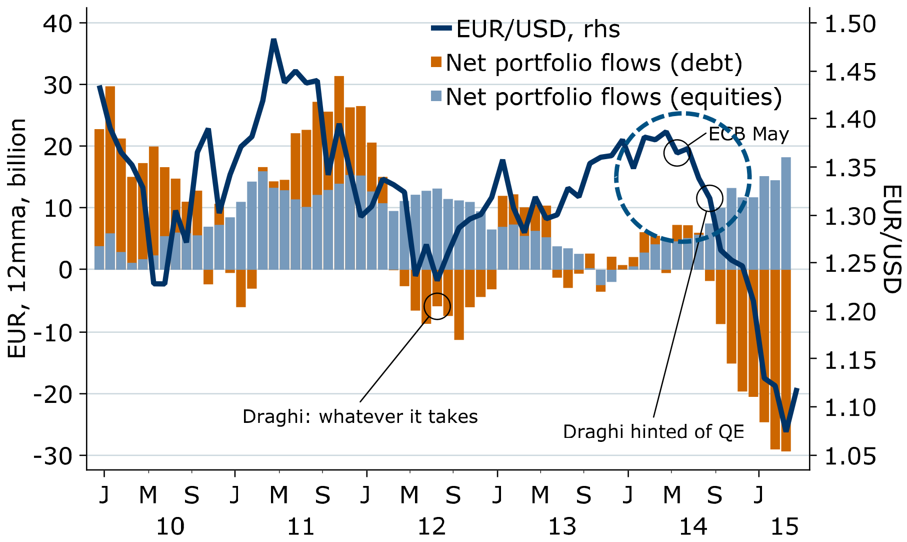
- SEK is "too strong" given its normal relationship to rates. **If QE matters, EUR/SEK will be pressured lower**
  - Valuation suggest appreciation : SEK 15% weaker than usual
- However, **a stronger krona than the Riksbank predicts will boost easing speculation, holding the SEK back** – especially ahead of possible inter-meeting dates



Sources: Nordea Markets and Macrobond

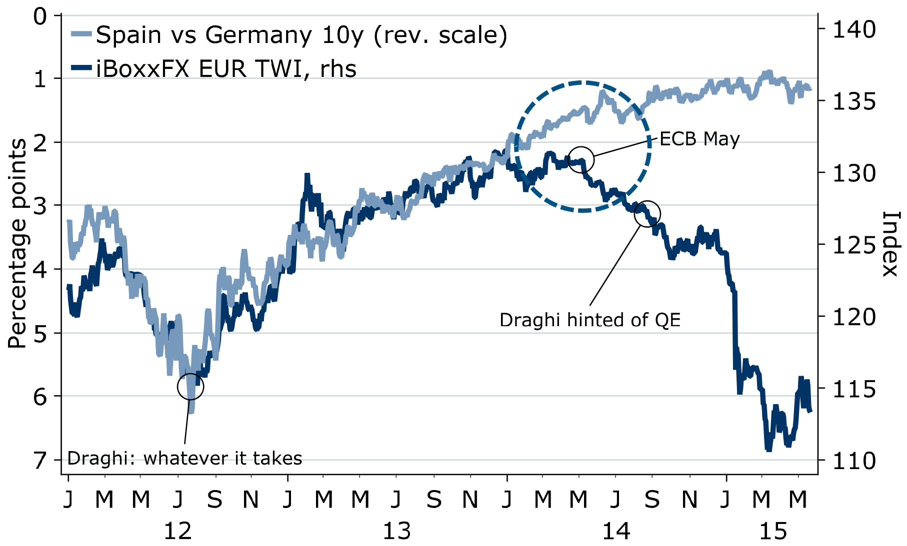
EUR: the changed nature of the euro

The nature of the EUR has changed owing to the ECB – from a currency in which you invest to one in which you fund (or avoid). Empirically, this notion is supported by the big swings in net portfolio flows last year, and by the "decorrelation" of the EUR. The nature of the EUR is unlikely to change back until the market ponders an end to negative rates.



Sources: Nordea Markets and Macrobond

- **The nature of the EUR has changed – from a currency in which you invest to one in which you fund (or avoid)**
- ECB's softening last year prompted big swings in net portfolio flows: *all in* equities but avoiding EUR bonds, corroborating this story
  - **SWFs & CBs are allergic to negative rates**, discussing diversification from the negative rate EUR to the "high-yielding" JPY
  - ECB QE/policies to trigger more FX spill-overs than Fed QE did for e.g. spread valuation reasons
- **The nature of the EUR is unlikely to change back until the market ponders an end to negative rates**



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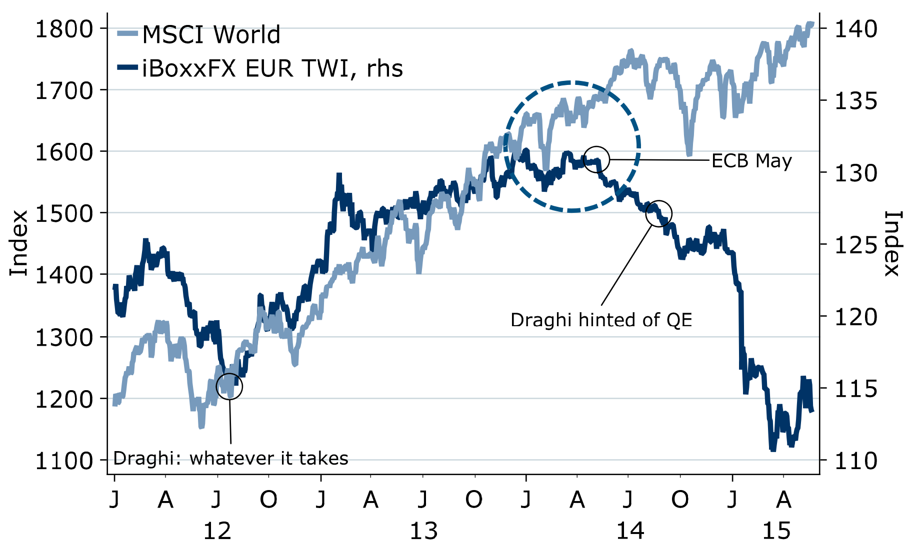

Sources: Nordea Markets and Macrobond

Thank You!

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