

am
FX

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Richard Westall's
Sword of Damocles (1812)

Current Views

Bullish EURGBP

Long 18MAR 0.8550 EURGBP digital
call at 24% (spot ref. 0.8426)

Bullish AUDCAD

Long 22FEB 0.91 AUDCAD call
Cost 26bps, spot ref 0.9050

Occam and Damocles

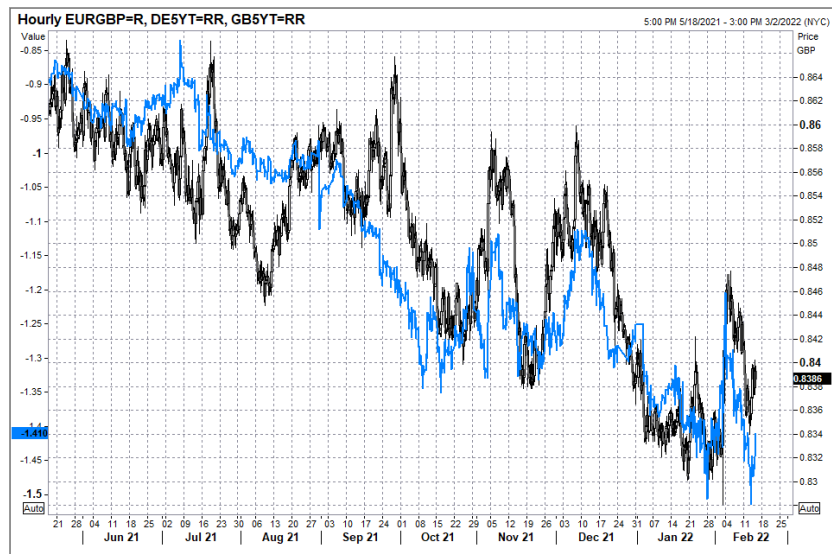
The Ukraine story is a Sword of Damocles hanging over risky assets as it's kind of impossible to model, expensive to hedge, and hard to trade. A 3% chance of a multi-nation hot war that includes nuclear-armed superpowers, a 75% of prolonged and unresolved tensions and 22% "Other". If you don't know the story of the Sword of Damocles, I put it as today's non sequitur. It's a cool story that conveys "the grass ain't always greener," "careful what you wish for," and "with great power comes great responsibility" in a few short paragraphs.

Occam's Razor

In my bullish EURGBP piece last week, I focused on the relative yield curves of Germany and the UK and how this potentially delineated the difference between the ECB, a central bank that is early in the cycle and hiking into strength vs. the Bank of England, a central bank that has done most of the heavy lifting already and is hiking into weakness.

While I clearly stated that is a multi-week view, it has not started out well. Sadly, the complicated juxtaposition of yield curves was useless while the most basic approach worked fine. Here is EURGBP vs. 5-year rate differentials.

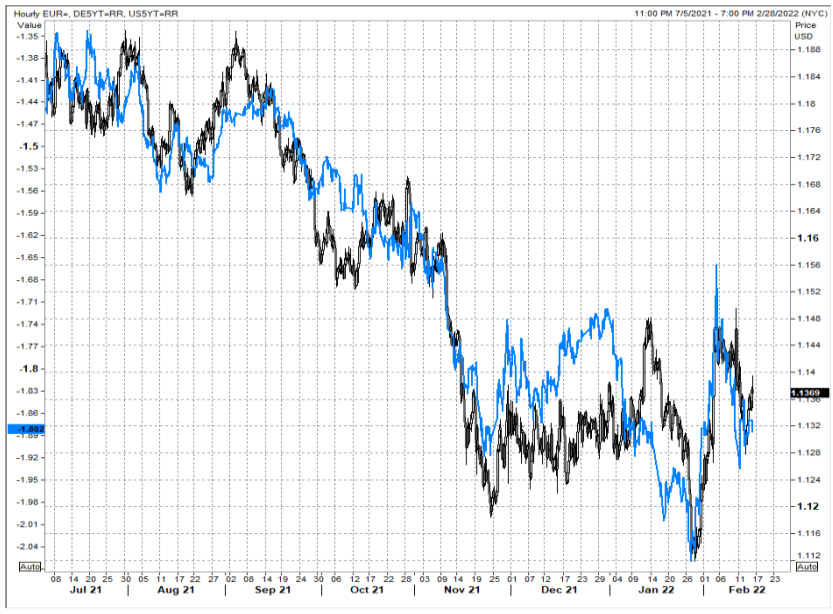
EURUSD vs. Germany/UK 5-year rate differentials



This is consistent with my experience over most of my career. Simple yield differentials are generally the best way to estimate where currencies are going. People will flash the yield curve analysis, and 1y1y vs. 2y2y and swaps vs. rates and curve shape and all that. But mostly, it's just the broad direction of interest rates in a country vs. another country that sets the tone for G10 FX. I made a mistake in getting sucked in to a more complicated framework that has not worked in the short run. I do still believe in the trade because I think the room for surprise on outright yields is still higher in Europe and lower in the UK.

For what it's worth, the same story has been true in EURUSD. Interest rate differentials have been an excellent barometer of EURUSD too. There is no signal of divergence right now, they are moving in tandem.

EURUSD vs. Germany/USA 5-year rate differentials



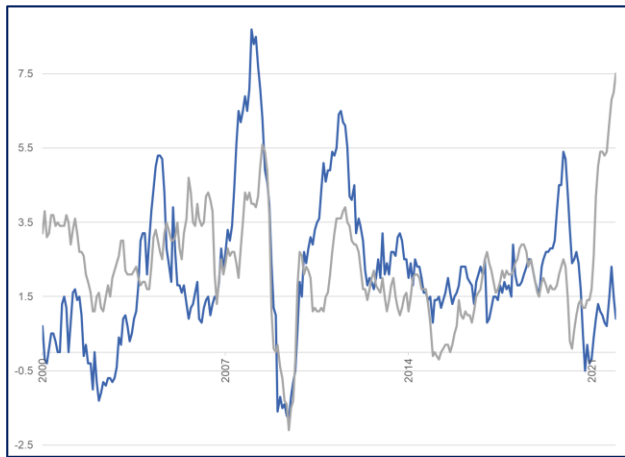
Retail Sales

I legitimately thought my platform was frozen after Retail Sales came out as there was zero initial reaction to this number. Yields didn't even *try* to go higher. Very strange. Possible red flag for bond shorts.

Inflation is not global

Finally, another potential headwind for US inflation. China prices are rolling over from low levels. That said, this cycle there has been no connection between Chinese and US inflation. The pockets of low headline inflation in Asia, particularly Japan and China, are rather eye-opening given the move in commodities.

US CPI vs. China CPI



Have a low stress day.

good luck ↑↓ be nimble

The Sword of Damocles

Damocles was pandering to his king, Dionysius, exclaiming that Dionysius was truly fortunate as a great man of power and authority without peer, surrounded by magnificence. In response, Dionysius offered to switch places with Damocles for one day so that Damocles could taste that very fortune firsthand. Damocles quickly and eagerly accepted the king's proposal.

Damocles sat on the king's throne, surrounded by countless luxuries. There were beautifully embroidered rugs, fragrant perfumes and the most select of foods, piles of silver and gold, and the service of attendants unparalleled in their beauty, surrounding Damocles with riches and excess. But Dionysius, who had made many enemies during his reign, arranged that a sword should hang above the throne, held at the pommel only by a single hair of a horse's tail to evoke the sense of what it is like to be king: though having much fortune, always having to watch in fear and anxiety against dangers that might try to overtake him.

Damocles finally begged the king that he be allowed to depart because he no longer wanted to be so fortunate, realizing that with great power comes great responsibility.

King Dionysius effectively conveyed the sense of constant fear in which a person with great power may live. Dionysius committed many cruelties in his rise to power, such that he could never go on to rule justly because that would make him vulnerable to his enemies. Cicero used this story as the last in a series of contrasting examples for reaching the conclusion in his fifth *Disputation*, in which the theme is that having virtue is sufficient for living a happy life.

From Wikipedia

Reminds me a bit of this careful what you wish for clip from The Watchmen



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