

MacroVantage

1. Nikkei Underperformance Flashes Opportunity
2. The Trilemma Bites: CHFJPY Is the Cleanest Way to Express Yen Downside
3. Don't Chase a Steeper US Yield Curve Here

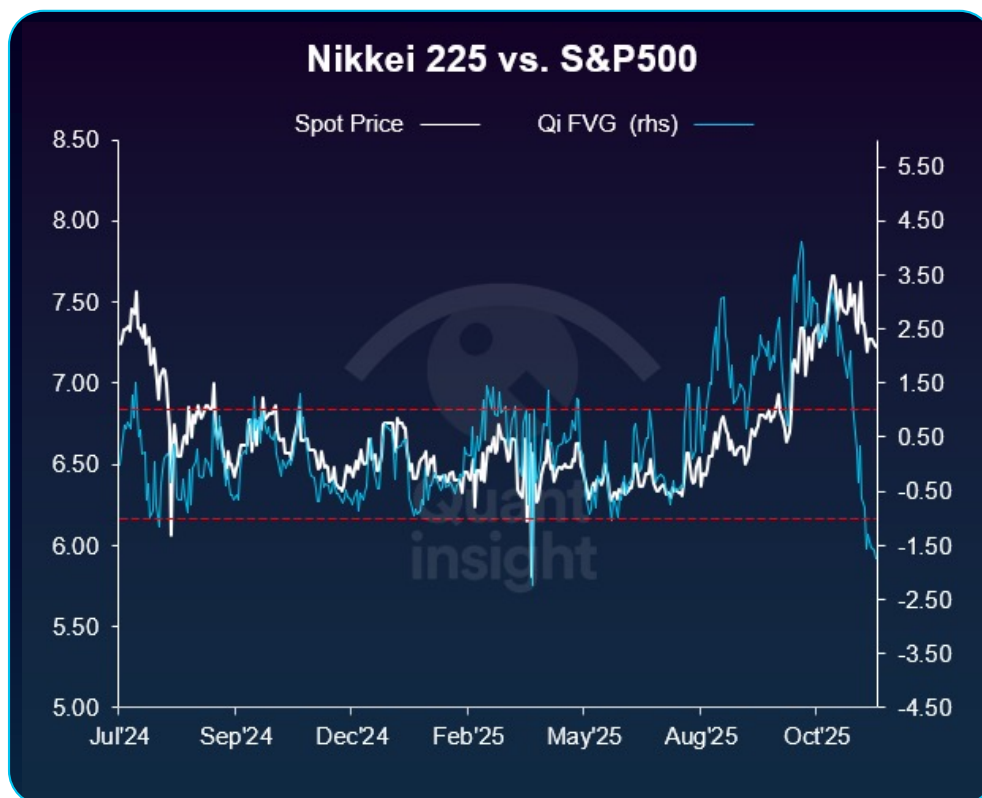


1. Nikkei Underperformance Flashes Opportunity

Through November, the Nikkei 225 has been in the red and underperforming the S&P 500. Japan yields have broken out in the back of the curve with the 30yr JGB yield hitting new 30yr highs. Plans for fiscal stimulus are now juxtaposed with the limits of the bond market. Hawkish rhetoric from BoJ's Ueda has made December a live meeting. Fiscal expansion is bullish for equities but higher bond vol risks creeping further into risk premia.

However, Qi shows a sharp dislocation emerging between the macro-warranted Qi model value and spot performance of the Nikkei 255 vs. S&P 500 ratio. The fair value gap is approaching 5yr lows at -1.74 sigma (-9%). Falling US inflation expectations, rising USDJPY and low US real yields have been supportive for the RV model value.

We highlight that since 2009, there have been 7 events where the ratio has traded at this level of FVG and macro explanatory power (above 60% RSq) – 5 out of 7 times the Nikkei outperformed from these levels over the subsequent 3 weeks (average holding period).



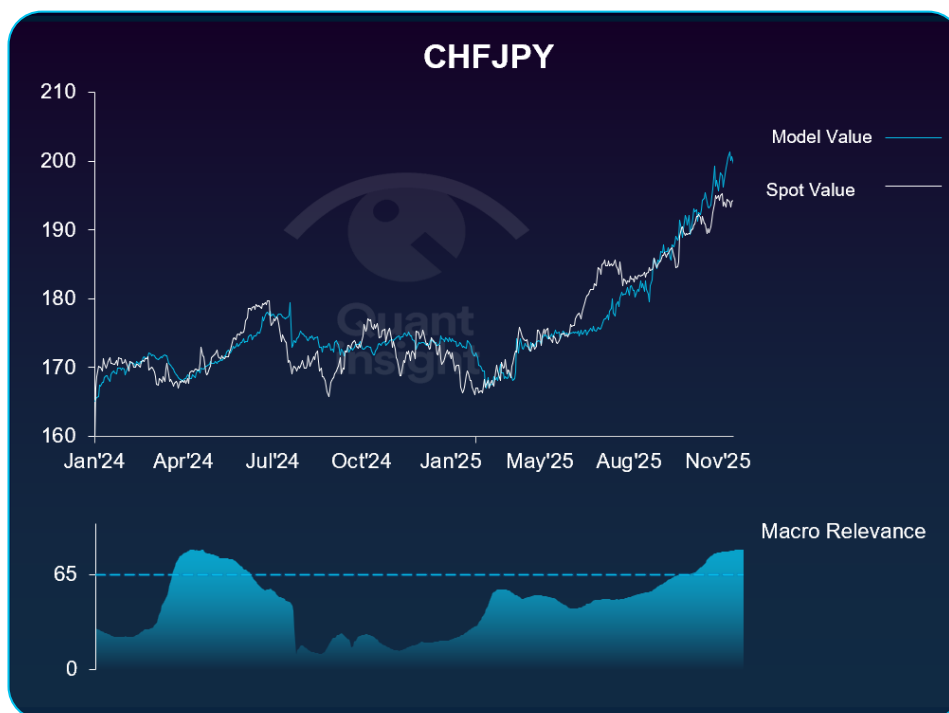


2. The Trilemma Bites: CHFJPY Is the Cleanest Way to Express Yen Downside

The back-up in JGB yields has found fresh momentum this week. But, in FX, Yen downside seems to have stalled somewhat.

For many, this doesn't make sense – the classic trilemma means, in a deficit country, rising bond yields don't reflect healthy reflation but a sign of stress. And, because policy makers will always tend to protect the bond market, it's currency weakness that becomes the pressure valve.

That makes Qi's CHFJPY model especially interesting right now. It is the cheapest Yen-G7 fx cross sitting 0.7 sigma (2.8%) below macro-warranted model value which continues to trend firmly higher.



Since 2009 there have been 21 occasions when spot CHFJPY has been in a macro regime & this cheap to Qi model value. A 76% hit rate & +1.1% average return suggests decent risk-reward.

Finally, it is also worth noting the biggest single driver right now is the difference in the 5s30s curve box. The relationship is negative, i.e. the bear steepening in JGBs relative to the Swiss yield curve has become a major drag on the Yen versus its fellow safe haven.

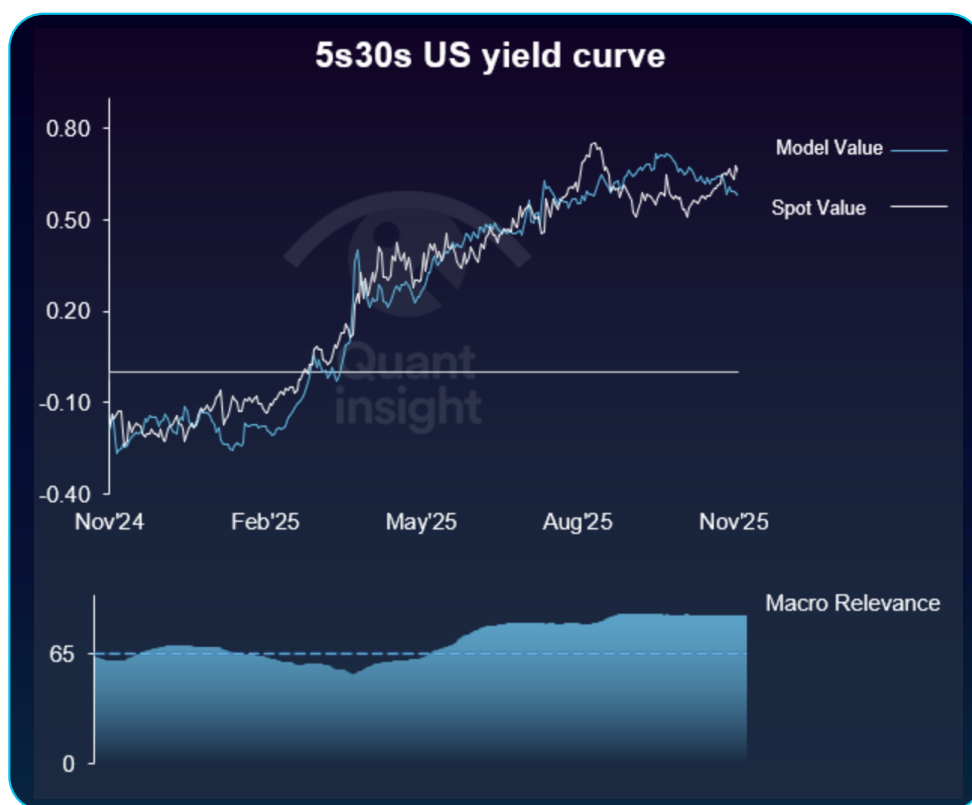
The simple message is these look efficient levels for bears to re-set Yen downside exposure.



3. Don't Chase a Steeper US Yield Curve Here

The Fair Value Gap is a modest 0.5 sigma (10bp) so its not enough to trigger a signal, but the divergence between the US 5s30s yield curve & Qi's macro-warranted model value is starting to look interesting.

Spot 5s30s has steepened around 20bp over the last month. Curve steepeners remain a consensus way to capture rate cuts & sticky inflation so the likelihood of Haseett as Fed Chairman has given the trade fresh legs.



On Qi, inflation expectations & Fed rate expectations are indeed big drivers of the curve. Yet Qi fair value for 5s30s has fallen from 65bp to 58bp over the same period. Even with the recent re-pricing in inflation & STIRT markets, the moves - when allied with broader macro factor shifts - are not supporting a steeper curve right now.

From Qi's perspective these are not optimal entry levels to pay 5s30s.



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