



# October 2014 “Risk-off” analysis

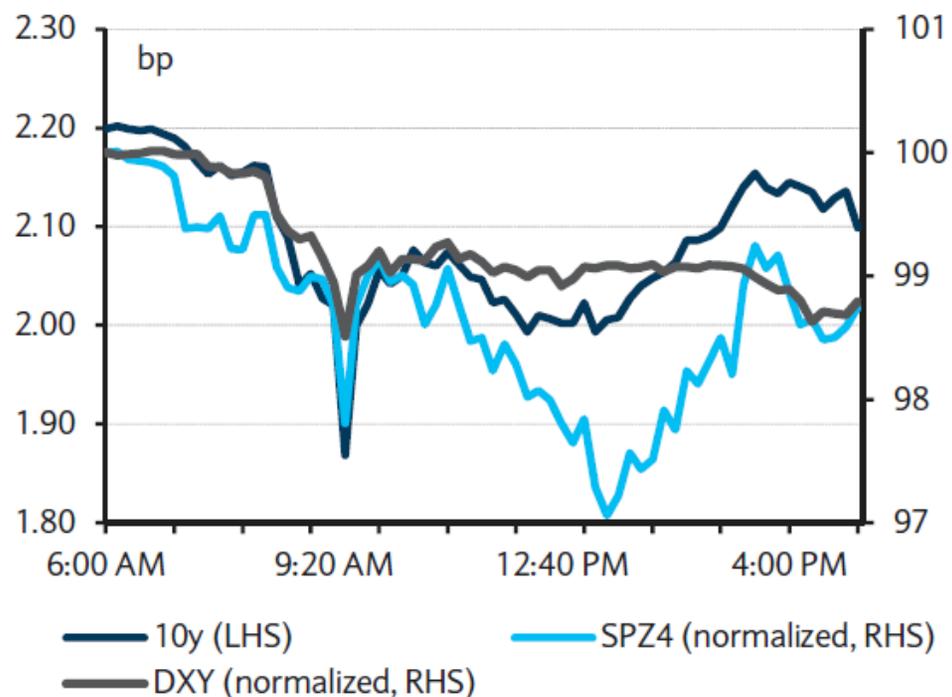
Jan Lundstrom

ECB BMCG meeting 27<sup>th</sup> January 2015

## Volatile markets across asset classes ....

Intraday volatility in Rates, Equities, Currencies – intraday spike largest in Rates

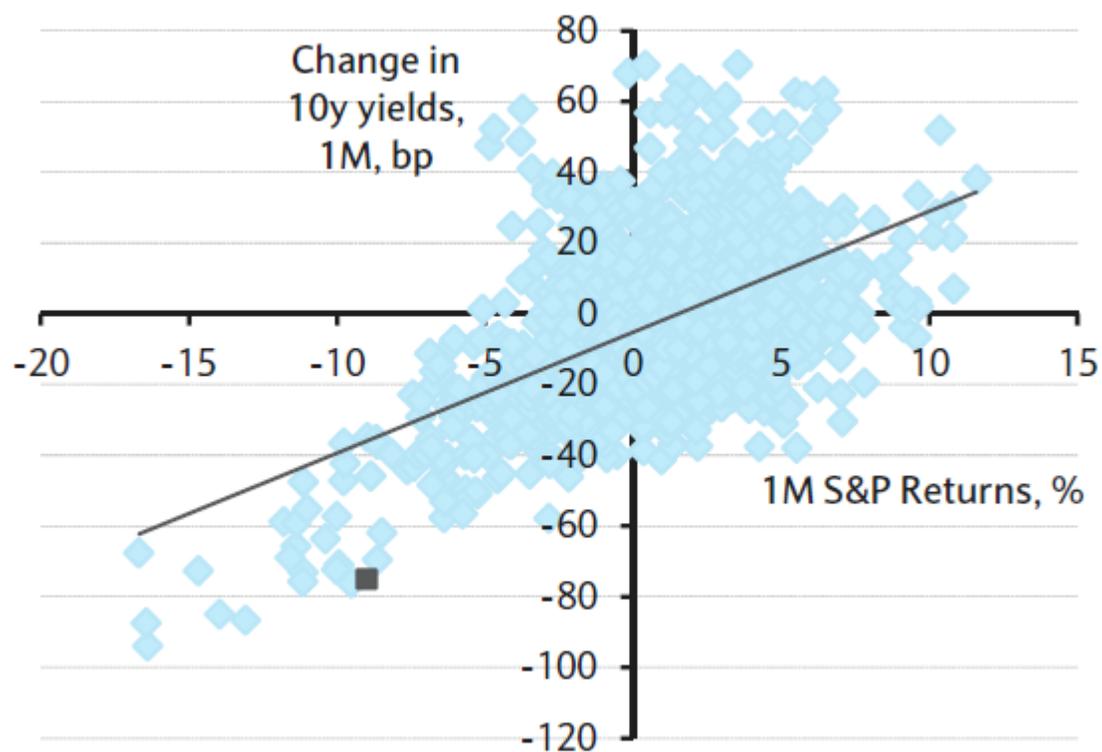
Major asset classes experienced significant intraday moves on October 15, 2014



Source: Bloomberg, Barclays Research

## ... 15-Oct move in Rates outsized

Rally in Rates was outsized, given the decline in stocks



Source: Barclays Research

## Drivers of outsize intraday market volatility

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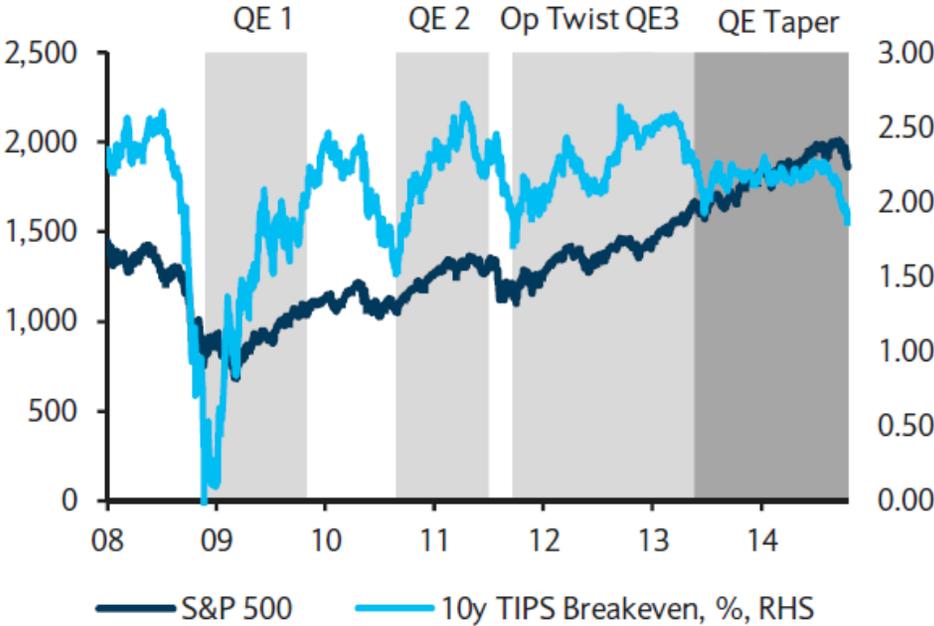
### A number of factors contributed to volatility on October 15

- Fed ending asset purchases contributing to stocks sell-off?
- Exceptionally high volumes in US Treasury trading on October 15
- US Treasury liquidity progressively withdrawn as market rallied on October 15
- Positioning: duration shorts at elevated levels
- Risk environment deteriorating in the first half of October: e.g. peripheral/core EGB spreads widening after positive price action over the summer period
- Broker dealer balance sheet contraction

# Equity market reaction around Fed asset purchase programs

Pattern of stocks selling off whenever the Fed has tried to end asset purchases

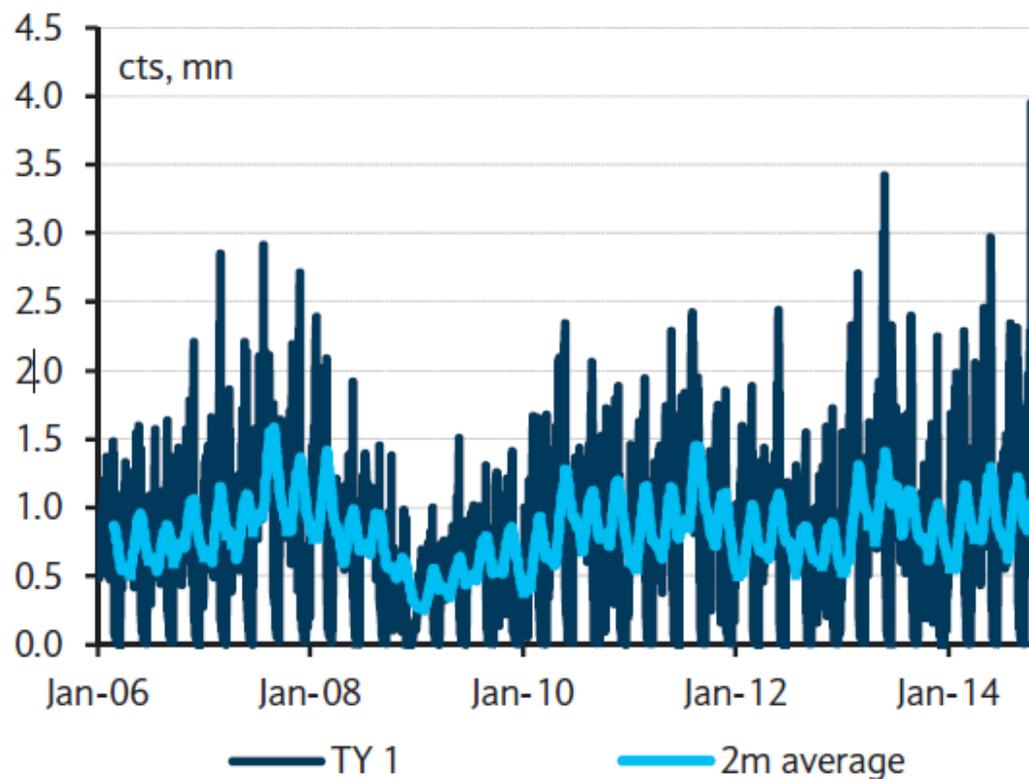
Stocks have sold off whenever the Fed has tried to end asset purchases



Source: Bloomberg, Barclays Research

# US Treasury trading volumes

TY trading volumes were the highest on record on Weds 15<sup>th</sup> Oct



Source: CME, Bloomberg, Barclays Research

# US Treasury liquidity plummets after initial rally

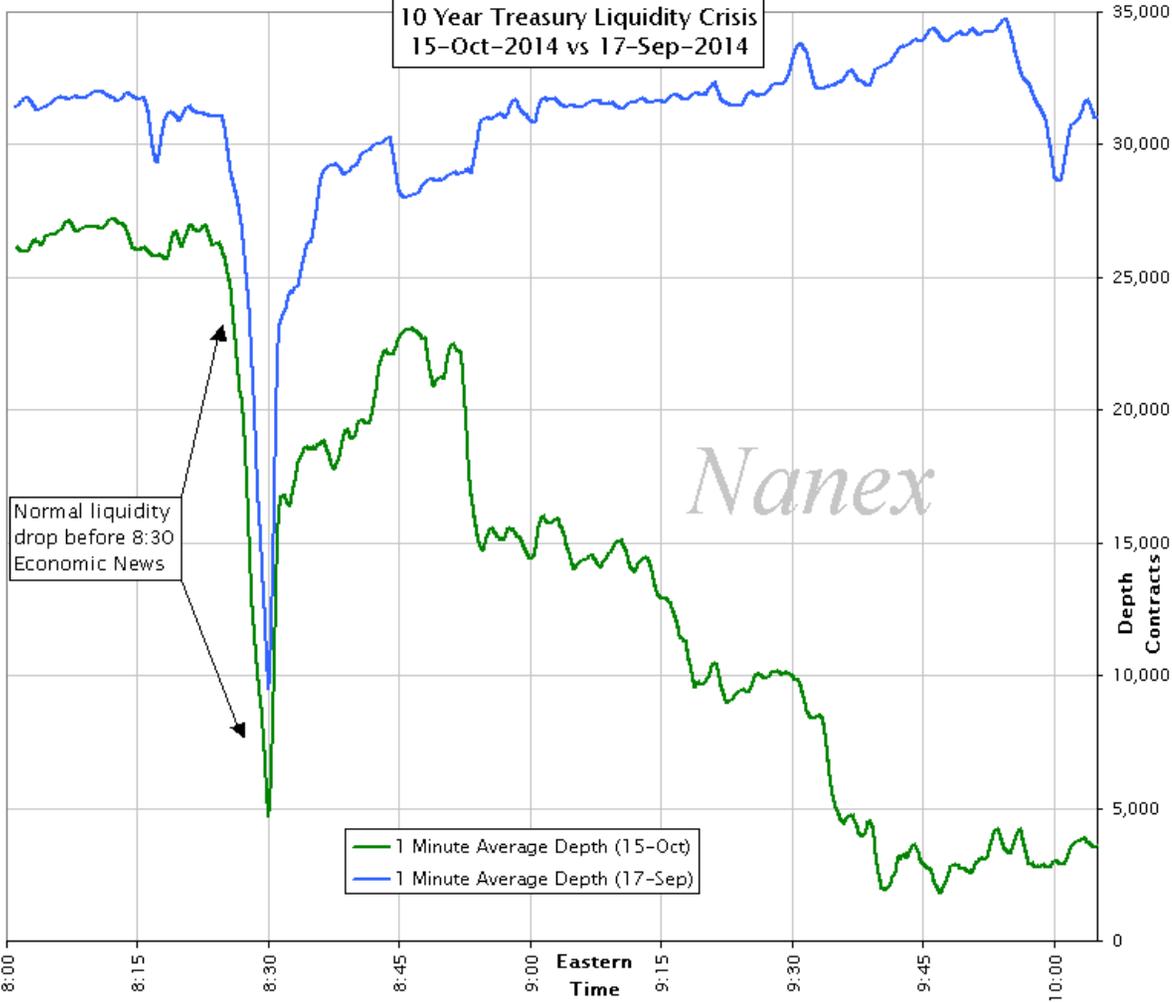
Liquidity in 10yr Treasury measured by total size of orders in 10 levels of depth of book



Source: Nanex

# US Treasury liquidity comparison – September vs. October

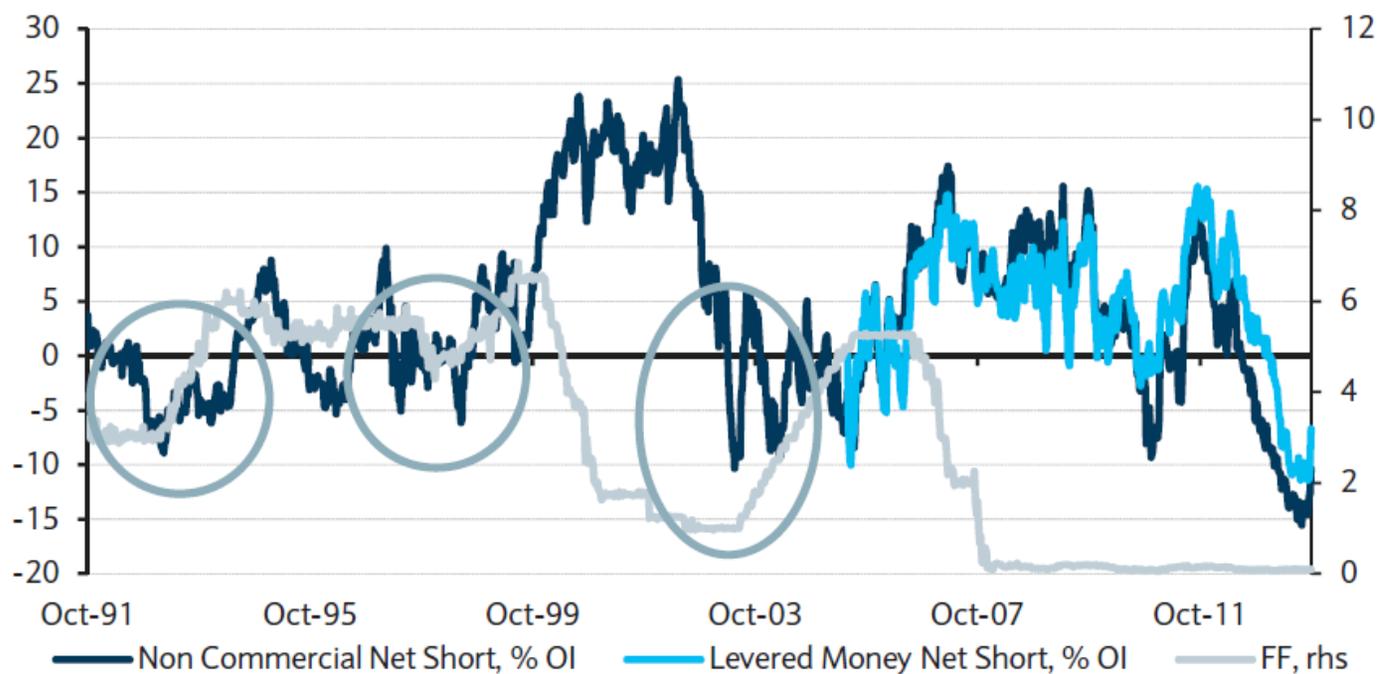
Liquidity in 10yr Treasury measured by total size of orders in 10 levels of depth of book



Source: Nanex

# Market positioning: Open Interest

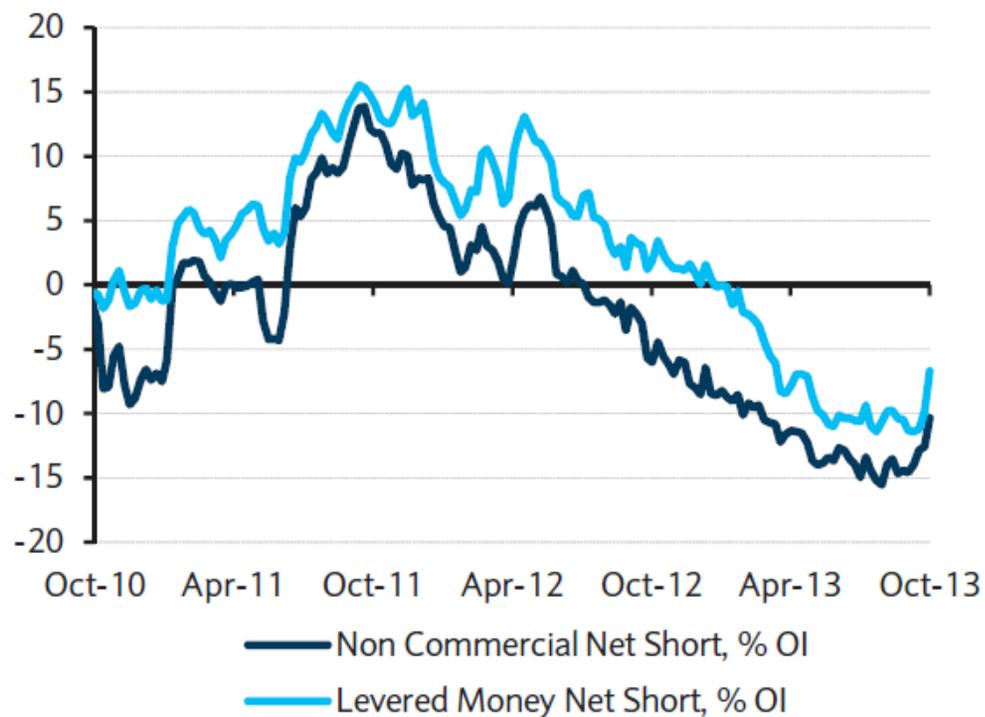
Short positioning in Eurodollars was at an extreme



Source: Haver Analytics, Barclays Research

# Market positioning: Open Interest

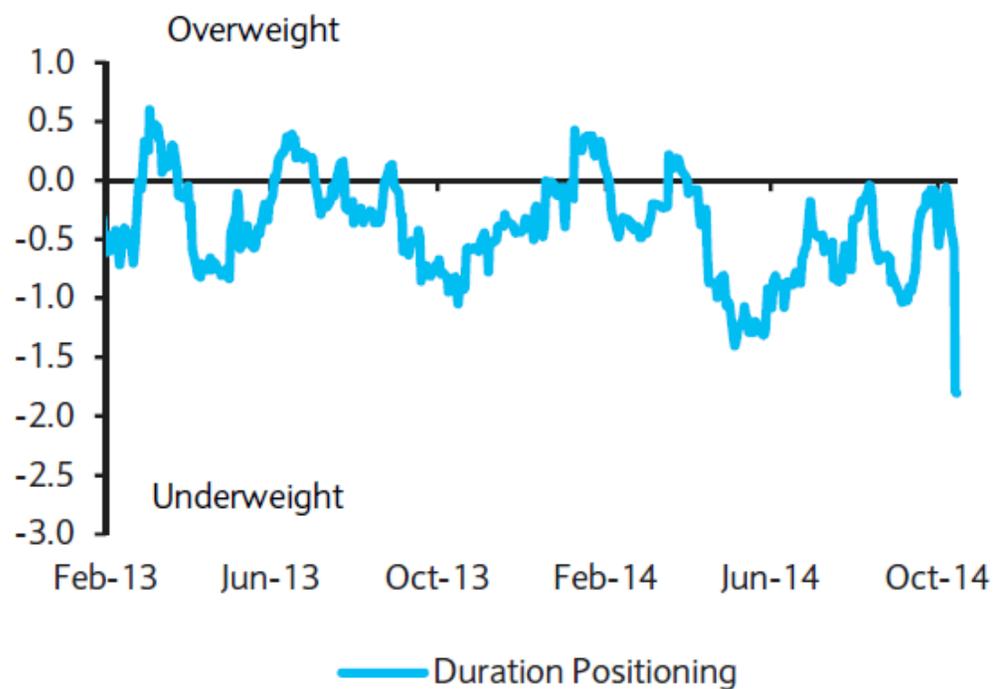
Eurodollars positioning: focusing on more recent data shows short covering from September onwards



Source: Bloomberg, Barclays Research

# Mutual fund positioning

Mutual fund positioning index also points to a large underweight duration versus the benchmark

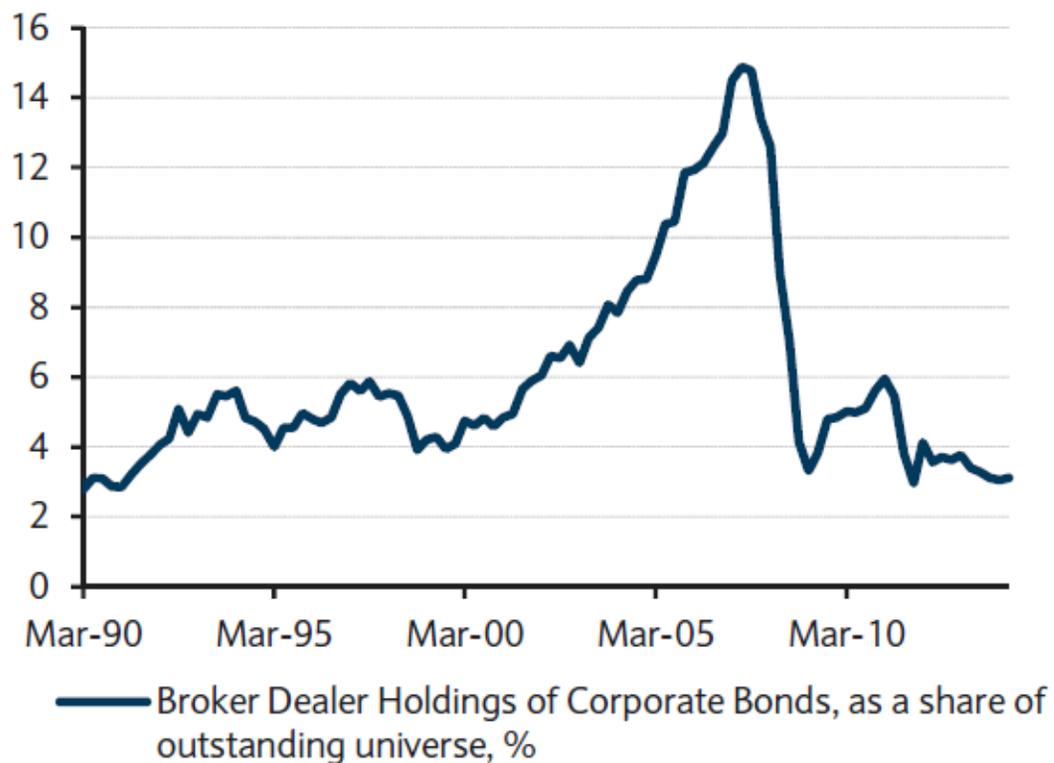


Source: Bloomberg, Barclays Research

## Broker dealer balance sheets shrinking (Corporate Bonds)

Broker dealer balance sheets are becoming smaller, especially in relation to the size of the market

Broker dealers balance sheets have shrunk relative to the market

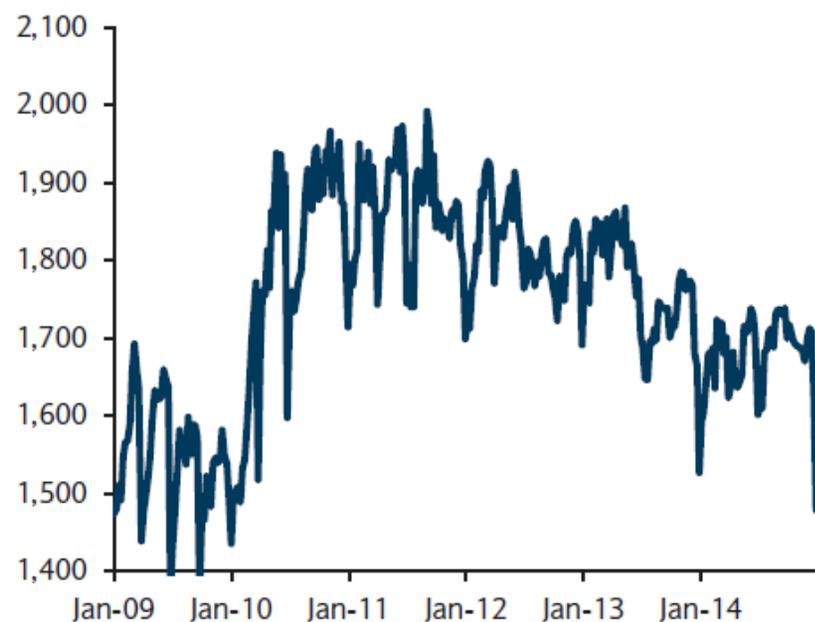


Source: Haver Analytics, Barclays Research

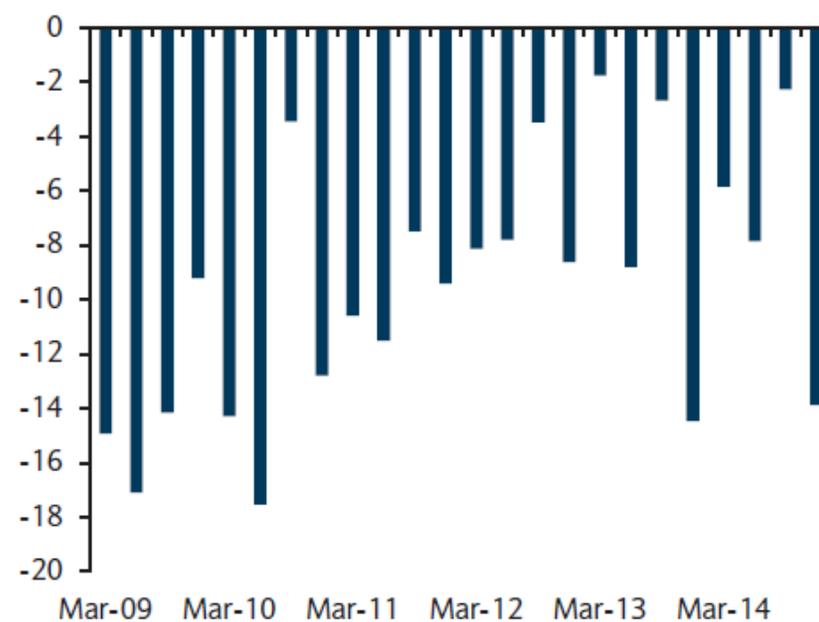
# Repo balance sheet availability (US Treasury repo)

Total Treasury repo volumes are trending lower, declining by around 15% between 2011 and 2014

Total government repo (\$bn)



Intra-quarterly peak-to-quarter-end balance (%)



Note: There is a definitional break in the Fed's repo data beginning in April 2013.

Source: Federal Reserve and Barclays

## Topics of discussion

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1. Overall assessment of the market volatility on Oct 15
2. Reduction in Risk Inventory – for cash products focus is on balance sheet utilisation
3. Changes to market making model
4. Market structure I: ability of dealers to supply immediacy services, availability of balance sheet
5. Market structure II: automation of liquidity provision leading to less robust markets?
6. Risk of future turbulence?
  - “Perfect storm” of one-off factors (extreme positioning, record volumes, risk environment changes) unlikely to repeat frequently
  - Structural factors (reduction in risk inventory, market structure changes) likely to have an impact on liquidity provision going forward
7. Relatively quick mean reversal from extremes - a trading opportunity? An opportunity for liquidity provision?

# Euro IRS 10s30s curve

January 6-7: Significant intraday volatility despite relatively moderate risk positioning and flow



Source: Bloomberg

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