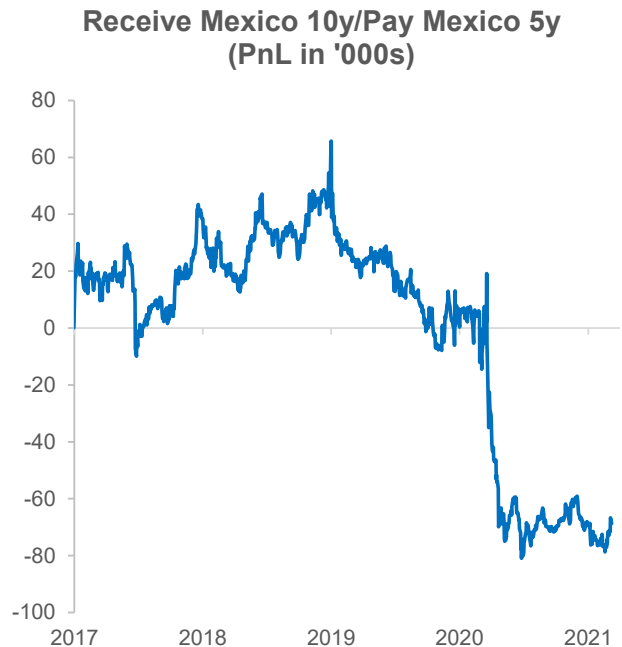
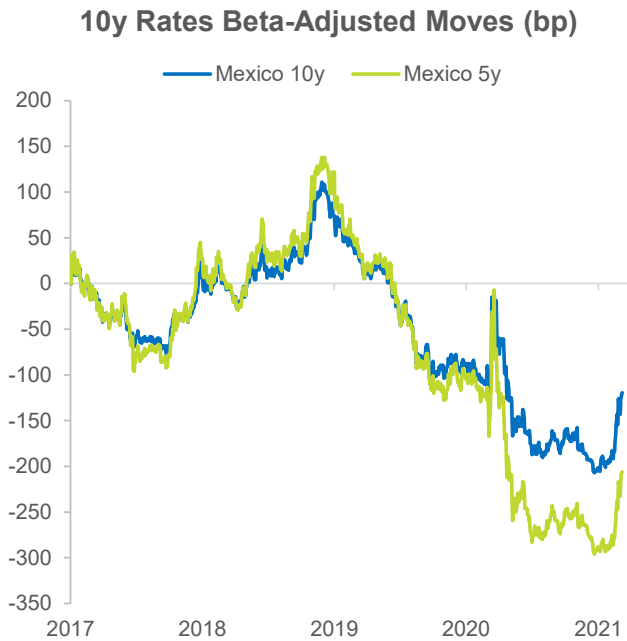


ALPHA BITES: Trade Ideas in EM FX and Rates

Mexico 5s10s Flattener with Paying Bias

Gautam Jain, PhD, CFA



	Receive Mexico 10y	Pay Mexico 5y
Current Levels	6.40	5.52
Beta-neutral DV01s	800	-1000
Amounts (USD mn)	\$1.1	-\$2.3
VAR (2y)	\$20,900	\$22,800
VAR of pair	\$11,300	

Z-Score/3m Return (not ann)	
Z-Score of Pair	1.8
Expected 3m Return	8.0%
3m Carry (bp)	-6
Total Expected 3m Return	7.3%

Expected Trade PnL Assuming	w/ carry	w/o carry
Mean Reversion	\$62,800	\$68,800
Levels - 1m ago	-\$11,300	-\$5,300
Levels - 6m ago	-\$7,000	-\$1,000
Levels - Best day in 4y	\$91,500	\$97,500
Levels - Worst day in 4y	-\$18,300	-\$12,300

*For return computation, we assume margin of 25% on Long + Short amts

Rationale

- In a previous [note](#), we discussed there is pressure on EM rate curves, including in Mexico, to follow the steepening in the US.
- However, EM long-ends are already pricing in high risk premia related to inflation and large fiscal deficits, limiting the pressure.
- The two scenarios that we envision are: 1) sell-off and steepening of US rates curtail, spilling over to Mexico, or 2) if the sell-off continues, then flattening pressure in Mexico should rise with rising outflows pressuring the peso, resulting in short-end pricing hikes.
- We like a 5s10s flattener in Mexico at current levels. Given the risk of further US rate sell-off and steepening, we recommend keeping a paying bias with less DV01 of 10y than 5y.

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