

ALPHA BITES: Trade Ideas in EM FX and Rates

Performance Summary of Trade Ideas – Jan 2022 Gautam Jain, PhD, CFA

- The tables below summarize the performance of all the trades recommended in currencies and rates in my Alpha Bites notes. All the closed trades have been italicized in the tables.
- As a quick recap of the performance of the trade recommendations:
 - I have made a total of 34 trade recommendations so far, of which 24 are in the money; 18 of the recommendations were in rates and 16 in FX.
 - Of the total 34 recommendations, I have closed 24 thus far: I recommended taking profits on 19 of them and was stopped out of 5.
- With regards to the trading environment:
 - As I discussed in [What to Expect of EM Rates when Expecting US Rates to Stay Volatile](#), the risk of US yields continuing to rise is high especially with inflation not having peaked yet, the Fed potentially reducing its balance sheet, and real rates still negative. **The high volatility in US rates does not bode well for EM rates** due to their high correlation even though EM local debt is overall cheap based on most metrics. Until the volatility in US rates subsides, **it is best to focus on cross-country and curve trades in EM**, with my preference for curve steepening trades (see below).
 - The **US dollar index** (DXY) has come off the peak but is still close to the highs since August 2020. Historically, the dollar tends to strengthen ahead of the Fed's tightening cycle and typically weaken once the cycle begins. This pattern would repeat only if the market had high confidence in the tightening priced in the curve, which is not the case. As such, **I expect the dollar to go through cycles of depreciation and appreciation throughout the year**. To minimize the dollar exposure, **my preference is for relative-value trades in EM currencies** (see below) as I discussed in my notes [Implications of Higher Dollar Volatility for EM Currencies](#) and [Not All Winners Are Equal: 2021 EM FX Outliers and Implications for 2022](#).
- Since the last monthly [update](#), I recommended closing the following:
 - **Long Chilean peso (CLP) vs Short South African rand (ZAR)**: Following the market-friendly outcome of the first round of the presidential election, I got an opportunity to recommend taking profits on this trade (see [here](#)).
 - **Receive Czech 5y (CZK 5y) vs Pay Poland 5y (PLN 5y)**: With the Polish central bank surprising the market by hiking aggressively but matching my expectation, the trade reached my target and allowed me to recommend closing it (see [here](#)).

- **Long Romanian leu (RON) vs Short Czech koruna (CZK):** I got stopped out of this trade as the Romanian central bank continued to raise rates slowly in contrast with the Czech central bank, which has remained hawkish even after raising rates aggressively.
- **My current open recommendations are:**
 - **Steepening trades in [Russia](#)** (Receive RUB 2y vs Pay RUB 5y), **[Czechia](#)** (Receive CZK 5y vs Pay CZK 10y), **[Brazil](#)** (Receive BRL Jan 27 DI vs Pay BRL Jan 31 DI), and **[Colombia](#)** (Receive COP 5y vs Pay COP 10y): I expect curve steepening trades to be a major theme for 2022 as I discussed in [Alpha Bites: Thematic Rate Curve Steepening Trades in EM for 2022](#). Of the four trades, the one in Russia now has an additional risk because of the unpredictable reaction to curve slope if Russia were to invade Ukraine. So far, while the curve has flattened in Russia, the high carry and the net short position has helped the trade.
 - **Short Chinese renminbi (CNY) vs Long Korean won (KRW) and Malaysian ringgit (MYR):** Growth in China continues to slow as I expected leading the central bank to cut the policy rate in addition to the second cut in the reserve requirement ratio (RRR) for banks. Thus far, the impact on the renminbi from the growth slowdown has been overwhelmed by the trade surplus (see the trade notes [here](#) and [here](#)).
 - **Long Thai baht (THB) vs Short Singapore dollar (SGD):** The omicron variant delayed the revival of tourism in Thailand. However, with cases peaking, the government has allowed quarantine-free travel again for vaccinated visitors, which should be supportive of the currency (see the trade note [here](#)).
 - **Long Hungarian forint (HUF) vs Short Czech koruna (CZK):** As I discussed in my [note](#), the forint should make up for its underperformance with the Hungarian central bank continuing to raise rates, while the Czech central bank is likely approaching the end of the cycle. However, the upcoming election in Hungary is weighing on the currency.
 - **Long Indian rupee (THB) vs Short Indonesian rupiah (IDR):** Omicron-related growth fears in India may be overdone and the pressure on the RBI to tighten monetary policy should increase on rising inflation expectations and with the Fed tightening. Shorting Indonesian rupiah against INR makes sense as Bank Indonesia should delay rate hikes due to the weak economic recovery and benign inflation, even if the Fed starts hiking (see [here](#)).
 - **Receive Mexico 5y (MXN 5y) vs Pay India 5y (INR 5y):** Real rates in India are the lowest among major emerging countries, which along with rising inflation expectations and strong growth should pressure the RBI to raise rates soon. Mexico is appealing as a receiver against paying in India because the central bank is further along in its monetary tightening cycle as is evident from the high real rates (see [here](#)).

FX Trade Recommendations Summary

Date		Currency		Amount (USD mn)		Entry Price		Closing Price		Performance		
Initiated	Current or Closed	Long	Short	Long	Short	Long	Short	Long	Short	PnL ('000s)*	Return**	Ann Return
1/11/21	3/16/21	PEN	CLP	\$1.00	-\$0.36	3.60	719.19	3.70	723.60	-\$24.2	-8.9%	-41%
1/18/21	3/1/21	RUB	COP	\$1.00	-\$0.76	74.26	3460	74.04	3613	\$38.5	10.9%	147%
2/1/21	3/29/21	PLN	CZK	\$1.00	-\$0.97	3.73	21.47	3.94	22.13	-\$26.1	-6.6%	-36%
2/8/21	4/21/21	KRW	TWD	\$0.70	-\$1.00	1119	28.00	1119	28.12	\$3.4	1.0%	5%
2/22/21	8/4/21	MXN	CAD	\$0.54	-\$1.00	20.79	1.263	19.82	1.254	\$27.6	9.0%	21%
4/12/21	6/22/21	IDR	SGD	\$0.50	-\$1.00	14595	1.340	14403	1.346	\$14.2	4.7%	27%
4/19/21	5/3/21	RUB	ZAR	\$1.00	-\$0.80	76.23	14.23	75.20	14.45	\$26.0	7.2%	514%
5/17/21	10/6/21	CLP	AUD	\$0.90	-\$1.00	719.1	0.774	812.9	0.727	-\$32.5	-8.6%	-21%
5/31/21	12/29/21	RON	CZK	\$1.00	-\$0.82	4.03	20.86	4.36	21.97	-\$26.4	-7.2%	-12%
6/21/21	8/23/21	INR	KRW	\$1.00	-\$0.80	74.1	1133.7	74.1	1171.5	\$34.3	9.5%	69%
7/12/21	1/21/22	MYR	CNY	\$0.70	-\$1.00	4.19	6.48	4.19	6.34	-\$28.4	-8.4%	-15%
9/6/21	11/23/21	CLP	ZAR	\$1.00	-\$0.90	769.0	14.3	807.0	15.9	\$43.6	11.5%	66%
9/27/21	1/21/22	KRW	CNY	\$0.60	-\$1.00	1180.5	6.46	1191.2	6.34	-\$29.3	-9.2%	-26%
11/8/21	1/21/22	THB	SGD	\$0.80	-\$1.00	33.1	1.348	32.9	1.344	\$0.4	0.1%	1%
11/29/21	1/21/22	HUF	CZK	\$1.00	-\$0.90	326.7	22.74	315.6	21.47	-\$17.1	-4.5%	-27%
12/20/21	1/21/22	INR	IDR	\$1.00	-\$0.72	75.9	14375	74.3	14335	\$19.7	5.7%	89%

*PnL estimates do not include transaction and other related costs; **Return computations assume margin of 20% on Long + Short amount; Data as of Jan 21, 2022, 5:00 pm EST

Rates Trade Recommendations Summary

Date		Rate		DV01		Entry Price		Closing Price		Performance		
Initiated	Current or Closed	Receive	Pay	Rec	Pay	Rec	Pay	Rec	Pay	PnL ('000s)*	Return**	Ann Return
1/25/21	4/5/21	Chile 10y	Mexico 10y	1000	-840	2.65	5.45	3.36	6.84	\$49.6	11.1%	73%
2/15/21	3/1/21	SAGB 7% 2031	ZAR 10y IRS	825	-1000	9.02	6.76	9.36	7.46	\$42.5	7.5%	565%
3/1/21	5/3/21	Hungary 10y	Poland 10y	1000	-1000	2.41	1.69	2.54	1.95	\$14.6	3.2%	20%
3/8/21	5/21/21	Mexico 10y	Mexico 5y	800	-1000	6.40	5.52	7.07	6.40	\$29.2	4.2%	23%
3/15/21	5/5/21	Colombia 5y	Colombia 10y	1000	-1000	3.84	4.84	4.90	5.98	\$12.0	1.7%	12%
3/22/21	6/4/21	South Africa 10y	South Africa 2y	1000	-1000	7.61	4.52	7.23	4.40	\$25.9	1.7%	9%
3/29/21	7/26/21	Czech 2y	Poland 2y	1000	-1000	0.94	0.38	1.53	0.58	-\$29.9	-1.1%	-3%
4/26/21	6/15/21	Chile 10y	Chile 2y	1000	-800	3.51	1.31	3.88	2.22	\$33.1	3.2%	26%
5/10/21	5/21/21	Colombia 5y	Mexico 5y	950	-1000	4.73	5.88	4.97	6.40	\$29.8	3.2%	185%
6/14/21	10/7/21	Colombia 5y	Colombia 2y	1000	-900	4.71	3.40	5.95	4.99	\$11.0	4.2%	23%
6/28/21	1/21/22	Russia 2y	Russia 5y	850	-1000	7.47	7.28	10.99	9.98	\$1.9	0.1%	0%
7/19/21	11/1/21	India 5y	India 2y	1000	-900	5.26	4.29	5.66	4.92	\$16.6	1.2%	4%
7/26/21	11/22/21	Czech 5y	Poland 5y	1000	-900	1.69	1.15	3.20	3.18	\$29.8	3.8%	12%
9/13/21	11/1/21	Thailand 10y	Thailand 5y	800	-1000	1.52	0.90	1.80	1.39	\$26.0	4.5%	39%
10/4/21	1/21/22	Czech 5y	Czech 10y	1000	-1000	2.71	2.47	3.90	3.46	-\$12.5	-1.8%	-6%
10/18/21	1/21/22	Brazil Jan 27 DI	Brazil Jan 31 DI	1000	-1000	10.58	10.99	11.24	11.45	-\$6.0	-0.9%	-3%
12/6/21	1/21/22	Colombia 5y	Colombia 10y	1000	-1000	6.30	6.66	7.01	7.36	\$4.9	0.6%	5%
1/10/22	1/21/22	Mexico 5y	India 5y	800	-1000	7.71	5.61	7.44	5.62	\$22.3	2.5%	129%

*PnL estimates do not include transaction and other related costs; **Return computations assume margin of 20% on Long + Short amount; Data as of Jan 21, 2022, 5:00 pm EST

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