From:	charlie.mcelligott@nomura.com
Date:	1/16/2025 9:51:14 AM
Subject:	Nomura Cross-Asset: SCAR-TISSUE STILL AN ISSUE, BUT MODEST SIGNS OF "TURNING"

USD RATES / TREASURIES:

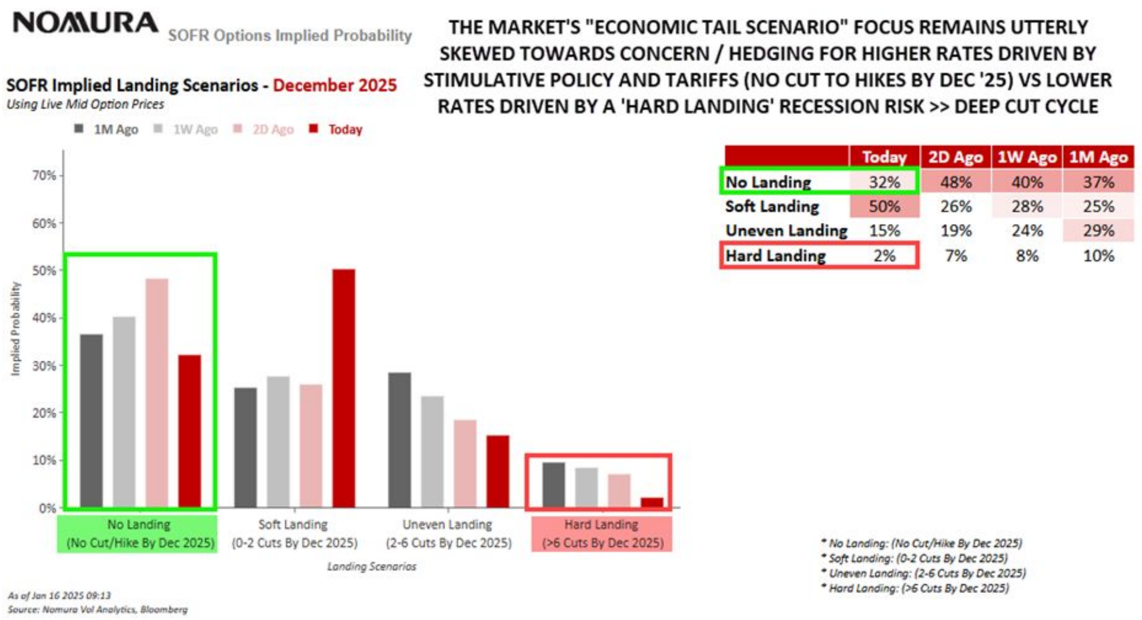
The UST term-premium rebuild which began in Sep '24 and reaccelerated post the US Presidential election of Trump **had kinda *dragged* consensus thinking of late (prior to this week's inflation data) into something that looked like this:**

- **Fed "High for Longer" assumption** based-upon 1) High fiscal deficit projections via stimulative policy and 2) "Sticky higher" prices risking upside inflationary pressures (meaning we remain above Fed target through 2025), particularly contributed to by Trump tariffs intent

- Broad "economic populism" pro-growth Domestic policy, Tech innovation / incubation / funding via strong Capital Markets inflows, and wholesale Deregulation shift was then contributing to **further extension of "US Exceptionalism," while the weaker fiscal countries / regions continue to relatively struggle…**

- A general acknowledgement (again, prior to this week's now released dovish-y inflation data, of course) **which suggested that the Fed may indeed be facing a "last-mile" sticky inflation issue, after their "policy error" 50bps opening cut in Sep '24**

- Hard-landing risk "left tail" risk sub 5 delta through at least the first half of year, while "right tail" animal spirits and inflation upside potential risk sees "no cuts" to outright Fed HIKES as recently as the past week being comfortably into the mid 30-40delta territory through YE25 (!)—a.k.a. **substantial asymmetry in the market perception on the probability distribution of "tail scenarios," with large Skew to risk / concern of *higher* Rates vs any remain thought paid to the idea of a Recession**



All the above perceptions / narratives in aggregate had then contributed to **concentrated positioning in (Bear) Steepeners, Long US Dollar and Shorts Bonds / big Payer over Receiver -Skews**

However, the "incrementally dovish" Inflation data this week has now forced some re-think of possible overshoot in portions of said prior narratives, and at the very least, some positioning adjustments / risk-management in pockets of these trades, which is what yesterday's price-action was primarily reflecting into this nascent Bond rally / BULL Steepening…

Nevertheless, to get more bullish in Bonds / Duration, many participants are telling me they need to see more follow-through with additional soft growth and / or inflation - data …as buyers in US Treasuries seemingly remain skeptical and scarred at least on the Long Duration –front (although you are finding NO ISSUES locating YIELD BUYERS in Long Tenor Spread Product, with Credit / IG Duration demand being silly oversized on all this fresh paper to start the year)

Yesterday's UST price-action showed a lumpy rebound y'day (10Y Real Yields largest 1d drop since Dec '23) after **the underwhelming CPI print followed-up on the PPI relief from the prior day then forced some large Short cover / Payer –monetizaton, while too seemingly even showing some signs of modest demand for actual "new risk Longs" located largely in the 5s-10s area**

UST flows in recent days had already pivoted into the first semblance of "Net Demand" we'd seen in quite some time, where even before the inflation data, we'd been seeing a few different Belly lifts from our international franchise earlier in the week….**and then yesterday –post data, we saw some Real Money buying in USTs (in the Belly) on top of the aforementioned Spec and potential short-dated Systematic Trend covers**

TLT: We saw some continued Upside Call buying Wednesday, following Risk Reversal (sell Put buy CS) flows that we saw on Monday, and **contributing to a real $2.2mm/01 lift over the past 1w**

- *Buyer of 89k Feb 90/93 Call Spreads for $0.34*
- *Buyer of 20k Apr 90 Calls for $1.42 vs. $82.62*
    - *Nomura client sold 12.5k Jun 80 Puts vs. bought 12.5k Jun 88/94 Call Spreads, paid ~$0.08 (1/13)*
    - *sold 10k Jun 78 Puts vs bought 10k Jun 92/100 Call Spreads (1/13)*
    - *sold 10k Apr 79 Puts vs bought 10k Apr 90/95 Call Spreads, paid $0.04 (1/13)*
    - *buyer of 7k Feb 88/90 Call Spreads for $0.41 (1/13)*

TY: Big buyer of short-dated Upside optionality

- *Tuesday we saw a **large buyer of 108.5 TYH Calls 1m expiry**, originally 30delta, **but already now firmly "in-play" and you could feel that Dealer "Short Gamma" hedging into the rally***

USD Rate Vol: Dumped post the dovish inflation data, as everybody was already so positioned / hedged for the selloff we'd been immersed within these past few months…**so rationally, the kneejerk trade on the sharp rally yesterday was seeing Payers unwound / monetized** (note that on Tuesday we'd already seen late Mar'25 10Y Put sale -29,500 THY5 106 Puts, 25 vs 107 -11/0.28%, which was to close)…**although worth noting that we did see some good sized Convexity –related Receiving late session, further iterating the market flow / chase back into UST Upside the higher we rallied**

Potential for CTA Trend Short Signal "Stop-In" Buy-to-Cover on sustained rally follow-through in coming days / weeks: As I noted last week with intent of signaling this very risk, the Shorts from Trend in G10 Bonds and STIRS had grown to prolific levels after extremely acute selling across both products over the past 3m period—per last Friday's note:

- *Exposure in aggregated G10 Bonds across our CTA Trend model shows just a 11%ile "Net Short" position since 2021, **with $Notional Sold since the September Fed meeting at 1%ile and the most aggregate selling since Feb '21 for any 3m period***

- *Exposure in aggregated Global STIRS across our CTA Trend model shows a 17%ile "Net Short" position since 2021, **with $Notional Sold since the September Fed meeting at 1%ile and the most aggregate selling since Nov '21 for any 3m period***

Accordingly, further "downside surprise" growth and / or inflation data against the still-substantial "High for Longer" expectations will see the market continuing to "add back" potential *Fed cuts* the distribution, after the selloff in USD Rates / USTs since December into y'day morning pre- Inflation data had seen ~60bps of previously priced Fed cuts being REMOVED over the past 1m, before yesterday's data…

Nevertheless, persistent UST demand remains a "Show Me" story, still with signs of "scar tissue" so far on a modest follow-through rally, and are not unabashedly "chasing" just yet, particularly with ongoing lack of sponsorship of the Long-End…despite what I pointed-out earlier was "frothy to ravenous" Real Money demand for *Spread Product* Duration (Credit and Mortgages)

See below for the next incremental "buy to cover" levels across the Nomura QIS CTA model in G10 Bonds and STIRS if this rally were to escalate further from here (Note: levels for today only) from unemotional / mechanical Systematics, noting specific attention to the magnitudes asymmetry of the $BUY (to cover) Skew into a generic "2% rally" vs almost nothing de minimis $notional to Short in the case of a projected "-2% selloff" from here

Bonds

Global Bonds Trigger Level Bands

	-4%	-2%	+2%	+4%
USD_2Y			+100.4	+100.4
USD_5Y			+5.5	+38.8
USD_10Y			+3.5	+22.3
USD_20Y				+0.8
AUD_3Y			+16.6	+16.6
AUD_10Y				+9.1
EUR_2Y	-52.6	-52.6	+42.0	+42.0
EUR_5Y			+34.9	+38.0
EUR_10Y			+13.2	+23.7
EUR_30Y				+1.8
GBP_10Y			+3.0	+3.0
JPY_10Y			+73.2	+79.7
CAD_10Y			+11.2	+14.4
CHF_10Y			+2.7	+2.7
FRA_10Y			+4.4	+7.2
ITA_10Y	-4.1	-4.1	+1.9	+2.4
ESP_10Y			+1.9	+2.9
Total	-56.8	-56.8	+314.3	+405.7

STIR

Global STIR Trigger Level Bands

	-4%	-2%	+2%	+4%
SFR4			+64.7	+64.7
SFR8			+52.9	+52.9
ER4	-35.4	-35.4	+28.2	+28.2
ER8	-36.4	-36.4	+29.0	+29.0
SFI4	-9.6	-9.6	+57.6	+57.6
SFI8			+53.8	+53.8
Total	-81.3	-81.3	+286.2	+286.2

Source: Nomura QIS, Nomura Vol

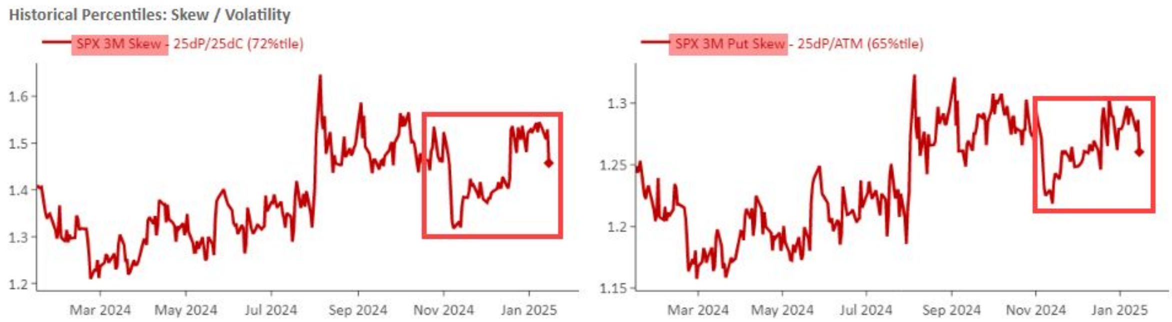
CTA position estimates

		Sig (today)	Sig (1d ago)	Sig (1w ago)	Sig (1m ago)	Pos (today)	Pos (1d ago)	Pos (1w ago)	Pos (1m ago)	Current price	Buy threshold	Buy d(signal)	Buy d(position)	Sell threshold	Sell d(signal)	Sell d(position)
Bonds	USD_2Y	-100	-100	-100	-96	-14.26	-14.24	-14.77	-11.24	102.72	102.9	29	4.07			
	USD 5Y	-100	-100	-100	-96	-5.51	-5.52	-5.57	-5.04	106.01	106.81	29	1.57			
	USD_10Y	-100	-100	-100	-96	-3.44	-3.44	-3.42	-3.3	108.26	109.73	29	0.98			
	USD_20Y	-100	-100	-100	-96	-0.77	-0.77	-0.75	-0.73	112.59	115.66	29	0.22			
	USD_30Y	-100	-100	-100	-96	-0.76	-0.76	-0.74	-0.71	117.28	121.66	29	0.22			
	EUR_2Y	11	11	-9	-55	1.51	1.5	-1.24	-6.27	106.6	107.06	29	3.83	106.59	-111	-14.95
	EUR_5Y	-100	-100	-100	-55	-5.4	-5.34	-5.31	-2.61	116.87	117.36	111	6			
	EUR 10Y	-100	-100	-100	-55	-3.37	-3.33	-3.29	-1.67	131.5	133.02	111	3.75			
	EUR_30Y	-100	-100	-100	24	-0.45	-0.44	-0.44	0.1	127.33	130.12	111	0.5			
	JPY_10Y	-100	-100	-100	-58	-11.32	-11.12	-11.24	-6.63	140.58	141	111	12.59			
	GBP_10Y	-100	-100	-100	-100	-3.03	-2.89	-2.97	-2.71	91.03	92.93	29	0.86			
	AUD_3Y	-100	-100	-100	-86	-2.36	-2.47	-2.45	-1.92	95.97	96.52	111	2.63			
	AUD_10Y	-100	-100	-100	-96	-1.29	-1.31	-1.3	-1.23	95.35	97.82	29	0.37			
	CAD 10Y	-100	-100	39	-55	-2.04	-2.04	0.79	-1.13	120.52	120.8	16	0.33			
	CHF_10Y	-100	-100	-79	24	-0.38	-0.38	-0.28	0.08	148.45	148.38	16	0.06			
	FRA_10Y	-100	-100	-100	-55	-1.12	-1.1	-1.08	-0.53	121.97	123.67	111	1.24			
	ITA_3Y	11	11	39	24	0.36	0.36	1.23	0.67	107.04	107.14	16	0.52	106.49	-111	-3.55
	ITA_10Y	28	-84	39	90	0.25	-0.77	0.36	0.77	118.67	120.21	44	0.4	117.4	-111	-1.02
	ESP_10Y	-100	-100	-100	-55	-0.41	-0.41	-0.4	-0.2	123.27	123.52	111	0.46			
MM	SFR4	-100	-100	-100	-58	-9.18	-9.17	-9.61	-4.07	95.96	96.07	29	2.62			
	SFR8	-100	-100	-100	-96	-7.51	-7.53	-7.84	-6.76	95.97	96.17	29	2.14			
	ER4	11	11	12	24	1.01	1	1.04	1.82	97.9	98.03	16	1.48	97.46	-111	-10.05
	ER8	11	11	-9	24	1.04	1.04	-0.85	2.01	97.76	97.87	16	1.52	97.56	-111	-10.33
	SFI4	-71	-100	-100	-100	-6.82	-8.83	-8.91	-7.84	95.8	96.03	111	10.62	95.75	-29	-2.72
	SFI8	-100	-100	-100	-100	-7.64	-7.31	-7.48	-6.72	95.87	95.97	29	2.18			

Source: Nomura QIS, Nomura Vol

EQUITIES:

Turning to Equities, behavior right now is what I'd call "constructive," where my previous "Tense Vol Market" focus re. how "bid" Skew / Put Skew (OTM Downside over ATM) had been, relative to negligible concern or demand for Call Skew (no fear of the "Right Tail" rally) then felt like a contrarian harbinger for reversal in Equities, especially after the recent de-risking exercise since mid Dec both with Fundamental Investors and Systematics *(Vol Control selling -$105B over the past 1m on the rVol reset higher)*

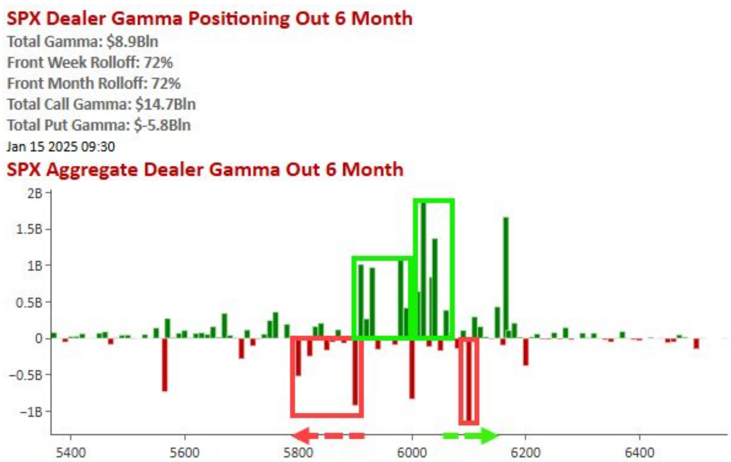


Source: Nomura Vol

Source: Nomura Vol

<u>The “still high” iVol and Steep Skew will increasingly look like attractive sales to the VRP universe,</u> where in the midst of a rather booming rally yesterday, Options sellers came out of the woodwork with renewed confidence…supplying Options back to **Dealers / MM’s to help them with their Gamma y’day after a somewhat rocky start to the year from Dealer hedging perspective**

- **Remember that eventually, that Gamma supply acts to choke Realized Vol and suppress daily ranges, which then further bleeds Vol into a virtuous feedback loop where Target / Vol Control funds eventually need to re-allocate more Equities exposure the lower that Vol resets**



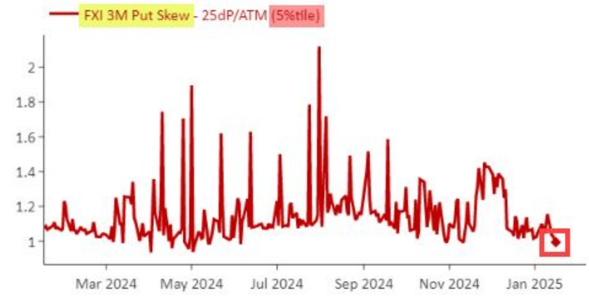
Source: Nomura Vol

Without a doubt too, **higher Stocks yesterday definitely brought about a bit of FOMO chasing too, seeing some outright signs of OTM Upside buying again, with Call Skew bid on QQQ, IWM, SPX, SMH and almost across the board**

Source: Nomura Vol

Outside of this resumption of "constructive" US Eq flows, **the one international flow in the Vol space which remains asymmetric is Investor demand for CHINA UPSIDE after its umpteenth positioning rinse, somewhat simplistically on the idea that upon Trump inauguration and "Day 1" tariff announcements, it then clears the path for Chinese authorities to then conduct counter easing / stimulus measures in short-order thereafter**

FXI PUT SKEW AT JUST 5%ILE ON ACCOUNT OF NOBODY OWNING THE UNDERLYING ANYMORE *(SO YOU DON'T NEED TO HEDGE ANYTHING, LOL…AS WELL AS STRUCTURED / AUTOCALLABLE FLOWS):*



Source: Nomura Vol

Yet once again, **Discretionary Macro is coming for China Eq Upside in recent FXI flows:**

Today more China Upside:

ASHR: buyer Feb 27/30 Call Spreads 6k x 9.6k, paid $160k

KWEB: buyer of 10k Sep 32 Calls for $2.34

Other recent "bullish" flows:

Nomura client bought 30k Feb 31/34 Call Spreads for $0.44 (1/14)

Nomura client bought 20k Feb 31 Calls for $0.58 (1/14)

Nomura client bought 7k Feb 31 Calls for $0.59 (1/14)

Buyer of 20k Jun 32/37 Call Spreads for $0.80 vs 28.80 (1/13)

Buyer of 30k Feb 32 Calls for $0.49 (1/7)

Charlie McElligott
Managing Director
Cross-Asset Strategy
Global Equity Derivatives
Nomura Securities International, Inc.

Worldwide Plaza 309 West 49th St. New York, NY 10019
Charlie.McElligott@Nomura.com