

As the calendar has rolled to November, the same themes remain in place for the program. Positions are in place to profit from the gradual steepening of the yield curve along with continued strength from the dollar, especially against the British Pound. Volatility has increased across the entire spectrum which has kept position sizing small to reduce the overall volatility in the program.

The main core position in the program continues to be yield curve steepening. While the long 2 year t-note portion continues to work, the short 10 year t-note has rallied sharply. The rally in the 10 yr can be attributed to a less hawkish fed and some slightly weaker data points on the economic front. With hedge funds loaded up short the 10 yr, we could see some more follow-through to the upside, but the massive increase in needed funding from the Federal government should eventually cap the rally. The potential largest change could be that we are transitioning from a bear steepener (yields going higher) to a bull steepener (yields going lower). During that transition, the longer end of the curve is free to move of its own accord while the 2yr is still tethered to the front end of the market. This could make the transition a bit shaky in the short-term. However, over the long term, the yield curve should normalize with 10 yr yields at least 1.5% over the 2 yr. Dips in the relationship will be used to add to the position.

The program continues to be short the British Pound through options. Economic data continues to show the economy contracting while the Bank of England has put rate hikes on hold. With a deteriorating economy and inflation remaining elevated, the BOE is stuck between a rock and a hard place. If they continue to raise rates to control inflation, they will crater an already weakening economy. If they don't raise, they risk a continuation of high inflation. Both scenarios point to the Pound weakening over time. While the trade has been erratic of late, the downtrend should resume.

Finally, a small short, defined risk trade has been put in place on the S&P 500. With US economic data starting to show some cracks and the stock market on a sharp rally, the risk/reward has fallen into place. There have recently been some strong anecdotal reports of the US consumer getting stressed. Credit card delinquencies and auto loan delinquencies have both risen in recent months. Those tend to be precursors to the capitulation of the US consumer and a roll-over in growth. While the non-farm payrolls were slightly lower than expected at 150,000 jobs added, some of that can be explained by the factory worker strike at the big three automakers. If the economy is starting to roll over, slower sales and lower earnings can be expected over the next year. When combined with p/e compression, the market should start pricing those multiples and show up in lower stock index pricing.

Sincerely,



Stephen Davis
November 7, 2023

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