DrobnyGlobalMonitor

May 12, 2011

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Biases:

EQUITIES:
BONDS:
FX:
EMG: Bullish Asian EMG FX; Bearish Asian EMG interest rates;

Current Exposure:

EQUITIES:
BONDS: Short CDA 10yr vs long Aussie 10yr (Apr 20);
Pay KRW 2yr Swap (Jan 13);
FX: ****Formerly Long KRW/JPY;***
****Formerly Short USD/SFr;***
****Formerly Long EUR vs TWD;***
COMMODS:

2011 NYC Conference Review

****Please note latest changes to biases and/or exposure***

Liquidity was a recurrent theme at our first NYC conference. Poor liquidity was behind the appeal of two esoteric trades presented by panelists - buying the beat up Icelandic Krona and the largely unknown Iraqi equity market. Any easing of illiquidity in these markets could prompt significant appreciation. Whether meaningful size can be achieved in these trades, especially the Iceland one, was a popular topic of discussion at the after party.

The potential withdrawal of liquidity played a prominent role in 2 other trades. One had to do with the end of QE2, and the volatility that might emerge as a result. The panelist suggested buying corporate CDS ahead of this. The other was a bearish trade at the front end of the US yield curve, based on the idea of a possible bringing forward of FED tightening. Combine all this by getting exposure to the illiquid option-like trades and simultaneously play for higher US rates/credit risk/volatility. A possible win-win if there is only a modest tightening of US policy.

But, probably the biggest story of the day was the drama unfolding outside of the room. The vicious price action in FX and commodities was quite a distraction, with many stopped out of positions during the day (guilty!). Yet, it also played a role in the proceedings. One panelist was totally on it, making the case for selling the Aussie. Just as it was falling sharply.

Is this simply a correction? Or the start of something more meaningful, now that growth has slowed and the end of QE2 looms. Does this mark a genuine turn in commodities and in USD weakness?

There were several intriguing audience poll results regarding all this. Participants were braced for slower growth (question 3, Section 10) and there was a general consensus that inflation fears were overblown. One suggested way to express this was to sell 1yr 1yr US inflation swaps.

So, imagine the surprise when a poll on the US outlook showed a small plurality of the group braced for a ***stronger*** growth outcome in the US (question 4 in Section 10)! That doesn't fit so well with the quiescent inflation view. It sounds more like our old friend, rosy scenario. But, it does fit with a general sense of bullishness about the US at this conference; it appeared in some presentations and in several poll results. The USD re-emerged as a favorite trade for some in the audience (Section 11). And, several panelists told bullish US stories, with one advocating buying US homebuilders.

Another striking feature of the polls: participants were modestly bullish oil (question 10, Section 10) but, if anything, they held bigger than desired exposure (question 11). Hmmm. The same was true with commodities in general (questions 12 & 13). People may be caught a little long here and one panelist commented that it seemed a deeper correction loomed.

Rounding out the panelist trades was a forward US yield curve steepener and a long Saudi equities trade. Both these trades generated the biggest controversy for some reason, yet the underlying stories seemed quite compelling.

I provide below a review of the 8 presentations and the subsequent discussions (bios of the speakers are provided at the end of this piece). Any comments in brackets [………] represent my own post-conference comments. Please remember that this is my own review of the proceedings. Suggestions, amendments, complaints, guest pieces, etc, would all be happily received. The more diverse the dialogue, the better!

1) Mike Novogratz of Fortress suggested selling the Aussie. This was all about location. Many big targets were hit following a solid period of trending commodity, equity and currency markets. 1.10 in the AUD/USD was one of those targets and so reaching this level seemed to offer a natural place to get short. Who wants to buy the Aussie up here after such a big move?

The question, though, is whether this is merely a correction, or the start of a bigger trend change. Novo did not express a strong view here; his point was primarily about location, although he did mention noises about the ANB intervening if the Oz strengthened further.

But, the beauty of the trade is that, if the recent volatility proves to be merely a correction, then the stop is real tight. And, if this is the start of something bigger, then AUD/USD could test and might even break below 1.00 again, which would open the potential for another good drop. Sometimes, he noted, markets turn and only later do we learn the fundamentals that justified the turn.

2) Ian Banwell of Round Table made the case for higher US rates and suggested paying 6mth 6mth or 6mth 9mth rates in the US. This exploits a very flat money market curve where 6mth rates are trading in the low 40's against a 3mth libor rate of 27bps. The trade thus costs little to carry and provides great leverage should any suggestion emerge that the FED will hike within the next year.

Ian argued there is good reason to expect a faster tightening than priced into markets. The private sector seems reasonably healthy, and current figures underestimate labor market strength. Ian pointed to job openings figures which have jumped up this year. Moreover, housing has bottomed and should provide a boost to growth from here. And, perhaps most importantly, core inflation seems set to move up to 2% y-y.

Moreover, the end of QE2 should lead to a big jump up in net Treasury supply. Ian believes the Treasury want to issue more duration and, to avoid a big rise in longer dated yields, the FED might well want to tighten early and encourage a flattening of the yield curve. That might help the market absorb the increased supply at the longer end.

How important was the core inflation call to his overall story? Ian admitted that, without this, the FED might well hold back. So, ironically, it seems the lower the inflation outcome the steeper the yield curve.

3) Dwight Anderson of Ospraie shared Ian's bullish story for the US and made the case for buying US homebuilders. Dwight declared himself an unrelenting US bull. And housing, which has been beaten up badly, is set to rebound. Especially production, which has bottomed at about 500K units built. He forecast an increase to 1.4mn by 2014, which is in fact the rough average since 1980. Behind this view is improved affordability, strong population growth and an improving jobs picture. He mentioned two specific stocks. One was NVR, which is a low risk/low return play. Or, better yet is Lennar, which has 20% short interest, almost all of its debt is non-recourse, and is priced at tangible book value. It's certainly a stock that has lagged the overall market recovery.

Capex spending was another feature underlying Dwight's bullish view, especially in the oil and gas industry. Big new oil reserves have been found in the Permian basin and returns are very high. Its not just easy access; recent productivity increases mean flow rates have increased sharply. Reserves can thus be tapped much more easily and rapidly than in the past. That means accelerated profit growth, something the market has not yet built into prices. This improved structural ability to manufacture and produce oil and gas makes Exploration & Production companies very attractive buys, and should herald a wave of capex spending.

4) Lee Thomas of Flint Rock avoided taking an explicit directional view and instead exploited some anomalies in the US yield curve, suggesting some forward steepening trades. His favorite was a 3yr fwd 10s/30s steepener. The 3yr forward 10/30 spread is flat against a spot curve that is trading at roughly 80bps, which is near historical highs. That is, the spot yield curve is very steep, yet the forward curve seems anomalously flat.

The 10s/30s spread has only been flat twice in the past decade. Once was just after the Lehman fiasco; the other time was when FED policy was very tight and FED Funds were trading at 5%. Yet, 3yr forward FED Funds are trading at around 2.25%. So, he urged, don't be fooled by the steep spot curve. A lot of flattening is priced in and hence a steepener trade offers great carry and good capital gains potential, especially if the FED stays friendly for a while longer.

Lee noted that the forward 2s/10s curve is also anomalously flat. He recommended as an alternative trade buying 3mth calls ATM ***forward*** on US 2yrs and selling 3mth ATM ***spot*** calls on the US 10yr. Because the call on the 2yr is in the money, this zero cost trade is a big earner should the yield curve remain unchanged. You break even if the yield curve shifts higher, and you should do well if yields fall.

This latter point proved controversial. One participant protested that Lee would get crushed in a bull flattener event. Not true, Lee responded. Due to the structure of the trade, where you own an ATM forward option and sell a spot one, a loss only occurs if the 2yr doesn't rally along with the 10yr. That's the disaster scenario: if the FED hikes preemptively, and this results in such a powerful flattening of the US curve that 10yr yields actually drop. Possible, but unlikely. In a poll taken after this debate, it was interesting that participants were modestly bearish and short Treasuries (questions 6,7). But, there was also a bias towards steepeners (questions 8,9). The advocate of bull flattening seems to have the advantage of being in the minority though as Lee noted, he is also fighting powerful forwards.

5) ***John Burbank of Passport Capital suggested buying Saudi equities.*** There is a persistent resource scarcity for which there is no short term solution. And, China is a massive long term buyer of the stuff. As a result, commodity prices have surprised to the upside and should continue to do so. This poses a genuine problem for non-solvent resource buyers, but is boon for producers like Saudi.

The Saudi market is generally misunderstood, in part because it is largely owned and priced by domestics. Foreign investors seem to view the Middle East as a single basket of risk and do not differentiate sufficiently political risk country by country. The risk of a major revolution in Saudi, he argued, is small. Yet they are major beneficiaries of higher oil prices. Both directly and indirectly due to the cost advantage of Saudi petrochemical companies. Moreover, high oil prices give the Saudi authorities room to spend more to mitigate unrest, and this serves to boost growth. This is thus a booming, under levered, resource rich economy with C/A and fiscal surpluses. And, valuations are attractive. Oil is up a lot this year, yet Saudi equities trading roughly flat for the year, even after the recent rally. What’s not to like?

Many questions were raised. What about liquidity? How can you get enough? John responded that there is, in fact, sufficient liquidity to build substantial positions in this market, as long as you take a longer term view. Wouldn’t sharply higher oil prices hurt equities generally, including Saudi? John suggested buying oil calls as a hedge against a long Saudi equity position, which oddly sounds like both a hedge and an augmentation of the exposure.

6) ***Bartle Bull of Northern Gulf Partners made the case for buying the Iraqi stock market index (ISX).*** You think Saudi is cheap? Take a look at Iraq, the mention of which probably causes a shudder or two. And, sure, there are political risks. But, he argued, all that is in the price with market cap at just 3% of GDP. Buying the Iraq stock index is a call option; maybe the value will go to zero, but if things turn out OK this could easily be a 10 bagger or much more.

Iraq is a large, resource rich, and fast growing economy with only 5% inflation. It’s a Middle Eastern country with water and is a major oil producer as well. Oil production is currently at 2.5-3mn barrels per day but could be above 10mn barrels in 5yrs. And, the equity index is trading at only 25% off war-time prices, in part due to poor liquidity.

What are you buying, and what size can you get on? The index is largely banks and tourism (hotels and land); it's essentially an early stage EMG market. There are 100 companies in the ISX, but only 35 actually trade. Daily turnover is about $3mn per day and you can build positions up to maybe $40-50mn. Liquidity is obviously not good, but that is also why the market is so cheap.

7) Robert Gibbons of Autonomy Capital suggested buying the offshore Icelandic Krona. Here is a safe haven type asset with a very high risk premium attached. It's a classic post-crash currency trade where the C/A is now in substantial surplus, so underlying flows are positive, yet the currency is trading near the lows and the forwards price in further depreciation. And, the fact that CDS is trading at 240 over now is means the credit issue is now much improved. Yet, the currency remains exceptionally cheap.

Especially the offshore rate, which has been held back because European holders of Icelandic debt can't sell it onshore and are continuously on the offer. The central bank wants to ultimately retire offshore ISK debt through auctions, and that could start in the next few months. That in turn, would allow liquidity to be restored and this would likely be the catalyst for both an elimination of the wide offshore/onshore spread and a big recovery in the onshore ISK rate itself. It's a huge trade, the problem is getting some on in decent size, if at all. Perhaps the real story is to be ready for a freeing up of trading again, because at that point the currency seems destined to rally sharply.

8) Adam Fisher of Commonwealth Opportunity Capital proposed buying US corporate CDS as a way to play for a vol pop ahead of the end of QE2. Adam argued that the biggest effect of QE2 has been to reduce vol and compress credit spreads, which has resulted in a negligible risk premium on corporate credit. Adam prefers IG names and financials for the trade.

One question that emerged is why corporate credit risk should rise if there is ample liquidity and no thus little-to-no funding pressures. That was the main catalyst in the past. Adam answered that this is not a crisis or margin call trade; rather that the risk is asymmetric, much more so than owning equity vol. Smaller catalysts have the potential to move the market a lot.

Andres Drobny

****Past reports can be accessed at www.drobny.com***

9) *Drobny Award Recipients*

Two combined Drobny Awards were presented at this conference to **John Burbank of Passport Capital** (best Guest Piece) and **Dan Tapiero of DTAP Capital** (best Trade). Both made the case for buying physical gold a year ago. They not only caught a powerful move up in the gold price, but the issue of a physical gold scarcity has garnered more attention recently and is becoming a hot issue. An early, excellent and really interesting nuance to the commodity bull story, which has proven profitable and seems to have legs.

10) Audience Poll Results (Questions asked during the Conference)

1) What is your current view regarding the Australian Dollar?

Very bullish	8	10%
Moderately bullish	22	26%
Neutral	19	22%
Moderately bearish	30	35%
Very bearish	6	7%
	Total Votes --85	

2) What is your current positioning in the Australian Dollar?

Very long	2	3%
Moderately long	14	17%
Neutral	44	55%
Moderately short	17	21%
Very short	3	4%
	Total Votes --80	

3) In the next 6 months, what will be the pace of global growth relative to current global growth rate?

A lot faster	3	4%
Moderately faster	20	25%
About the same	17	21%
Moderately slower	34	42%
A lot slower	7	8%
	Total Votes --81	

4) In the next 6 months, what will be the pace of U.S. growth relative to current U.S. growth rate?

A lot faster	6	8%
Moderately faster	30	37%
About the same	14	17%
Moderately slower	23	29%
A lot slower	7	9%
	Total Votes --80	

5) When will the Fed hike policy rates?

Before end of 2011	4	6%
Before middle of 2012	30	42%
Before end of 2012	21	30%
Sometime in 2013	11	16%
Sometime after 2013	4	6%
	Total Votes --70	

6) What is your current view regarding U.S. treasuries?

Very bullish	2	3%
Moderately bullish	16	22%
Neutral	10	14%
Moderately bearish	31	42%
Very bearish	14	19%
	Total Votes --73	

7) What is your current positioning in U.S. treasuries?

Very long	3	4%
Moderately long	11	17%
Neutral	27	41%
Moderately short	19	29%
Very short	6	9%
	Total Votes --66	

8) Will the U.S. treasury curve end up flatter than the forwards are currently pricing?

Strongly Agree	4	6%
Agree tentatively	17	27%
No opinion	9	14%
Moderately disagree	23	37%
Strongly disagree	10	16%
	Total Votes --63	

9) What is your current positioning in U.S. treasury curve trades?

Big flattening position	3	5%
Moderate flattening position	6	10%
No position	36	60%
Moderate steepening position	11	18%
Big steepening position	4	7%
	Total Votes --60	

10) What is your current view regarding oil (next 3 months)?

Very bullish	1	2%
Moderately bullish	27	42%
Neutral	15	23%
Moderately bearish	18	28%
Very bearish	3	5%
	Total Votes --64	

11) What is your current positioning in oil?

Very long	3	5%
Moderately long	20	32%
No position	33	53%
Moderately short	6	10%
Very short	0	0%
	Total Votes --62	

12) What is your current view regarding commodities generally?

Very bullish	2	3%
Moderately bullish	24	39%
Neutral	14	23%
Moderately bearish	17	27%
Very bearish	5	8%
	Total Votes --62	

13) What is your current positioning in commodities?

Very long	4	6%
Moderately long	25	42%
No position	22	37%
Moderately short	7	12%
Very short	2	3%
	Total Votes --60	

14) What is your current view regarding EUR/USD?

Very bullish	11	17%
Moderately bullish	16	25%
Neutral	8	12%
Moderately bearish	21	33%
Very bearish	8	13%
	Total Votes --64	

15) What is your current positioning in EUR/USD?

Very long	2	3%
Moderately long	13	22%
No position	25	42%
Moderately short	16	27%
Very short	4	6%
	Total Votes --60	

16) What is your current view regarding Brazilian equities?

Very bullish	2	3%
Moderately bullish	20	32%
Neutral	13	21%
Moderately bearish	21	34%
Very bearish	6	10%
	Total Votes --62	

17) What is your current positioning in Brazilian equities?

Very long	1	1%
Moderately long	14	23%
No position	39	65%
Moderately short	6	10%
Very short	1	1%
	Total Votes --60	

11) ***Summary of Audience Favorite Trades*** (Asked at start of the Conference)

FX: Total: 21

Largest samples:

4 Long NJAsia (1 vs Yen)
3 Long USD
3 Short Yen (1 vs NJAsia)
3 Short Sterling (1vs NOK, 1 vs SFr)
2 Long CNY
2 Short Euro

Most interesting/unusual: short 3-5yr JPY Vol; most diversified FX favorite trade list of any DG conference.

Fixed Income Total: 18

Largest samples:

4 Short Rates in US (2x short Q1 2012 Fed Funds, pay 1yr1yr swap);
4 Short Rates elsewhere (JGB's, NJAsia, Canada, long end Brazil);
3 Long Rates in US (Long 5 & 10yr T's, receive 1yr 1yr swap (!), receive 2yr 1yr fwd)
2 Long Rates in Brazil (NTNB's, short term onshore USD rates);

Most interesting/unusual: most diverse set of favorite trades of any conference.

Commodities Total: 9

Largest samples:

2 Long Gold
1 Short cotton
1 Short crude
1 Short copper
1 Long crude
1 Long sugar
1 Long Nat Gas
1 Long WTI Crack Spreads

Most interesting/unusual: Once again, most diversified commodity favorite trades!

Equities: Total trades: 13

Largest samples:

3 Short Equity vol (2x longer dated vol)
2 Long S&P
2 Long NKY (1 vs Bovespa)
2 Short Bovespa (1 vs NKY)

Most interesting/unusual: Long offshore W Africa E&P companies; Long 1yr ATM Fwd Bovespa Put vs Short 1yr ATM spot; Bovespa put (pos carry, short risk trade).

Other Favorite Trades: 4

Long Spanish CDS
Long US Corp CDS
Long CA munis
Long US Real Estate

PANEL BIOGRAPHIES ::: New York - 2011

Dwight Anderson ~ Ospraie

Dwight Anderson is the Managing Partner of Ospraie Management LLC, which serves as investment manager to the Ospraie Funds. The Ospraie Funds actively invest in various commodity markets and basic industries worldwide based on fundamental, bottom-up research. Mr. Anderson launched Ospraie in 1999 in partnership with Tudor Investment Corporation, where he served as Head of the Basic Industries group. In 2004, he established Ospraie Management, LLC as an independent firm. Prior to joining Tudor, Mr. Anderson was a Managing Director in charge of the Basic Industries and Commodities group at Tiger Management. Previously, he was an Associate at JP Morgan & Co. Mr. Anderson holds an MBA from the University of North Carolina and an AB in History from Princeton University. He is certified in production and inventory management by the APICS. Mr. Anderson serves on the Board of Trustees of NYU Langone Medical Center and UNC Kenan Flagler Business School. He resides in New York City with his wife Julie and their two children.

Ian Banwell ~ Round Table

Ian is the CIO and Founder of Round Table, a discretionary global macro manager based in Charlotte, North Carolina. Prior to founding the Firm, he previously served as Bank of America's CIO from 1999 to 2007, during which time he acted as Bank of America's principal risk taker. He was responsible for capital commitment, portfolio construction and asset allocation of domestic and international interest rate, credit and equity positions. Additionally, Ian managed both quantitative finance and certain research functions for Bank of America. Ian also served as Chairman of the Bank of America Asset-Liability Committee, Chairman of the Bank of America Equity Risk Forum and was a member of the Bank of America Finance and Management Operating Committees. Ian is currently a member, and past Chairman of the Treasury Borrowing Advisory Committee. He holds a B.A. degree in Economics from Washington & Lee University.

John Burbank ~ Passport Capital

John Burbank serves as the chief investment officer of Passport Capital, LLC, a San Francisco based global investment firm. We manage approximately $4.4 billion in assets. Our investment process uses a combination of macroeconomic analysis to develop major themes and rigorous fundamental research on individual companies to create global portfolios. Our investment team focuses on the following areas: Agriculture, Basic Materials, Consumer, Energy, Financial Services, Healthcare, India, Capital Markets, Internet / Technology, and Middle East & North Africa. Mr. Burbank has over a decade of experience investing in global equity markets. Prior to founding the firm in 2000, he was a consultant to JMG Triton Offshore, Ltd. From 1996 to 1998, Mr. Burbank was the director of research at ValueVest Management. He holds a B.A. degree from Duke University and earned an M.B.A. degree from the Stanford Business School.

Bartle Bull ~ Northern GP

Bull is a founding partner of Northern Gulf Partners (NGP), the leading investment firm in Iraq. He is the portfolio manager of Iraq Investment Partners I LP, the first and only equity fund focused exclusively on Iraqi equities. An emerging markets specialist, Bull has managed a variety of funds in Asia and Latin America, previously working with Jupiter Asset Management of London and Van Eck Global of New York. Bull co-founded NGP in June, 2008 after working as a political analyst in Iraq from 2004 to 2007, writing for the Wall Street Journal, the Financial Times, the New York Times, the Washington Post, and various other newspapers, and contributing frequently to broadcast outlets such as Fox News, the BBC, and NPR. In 2009 Bull was awarded a Commander's Award by U.S. General David Petraeus for "courageous and visionary" reporting. Bull received his BA from Harvard University and his MBA from Columbia Business School.

Adam Fisher ~ Commonwealth Opportunity Capital

Mr. Fisher is the Chief Investment Officer and co-founder of CommonWealth Opportunity Capital ("CWOC"). Fisher co-founded Orient Property Group ("OPG") in 2006 focusing on investments throughout the Asia Pacific region. OPG is backed by D.E. Shaw & Co. Fisher also founded Irongate, a property investment and development firm based in Los Angeles. Fisher previously worked in New York for two private equity firms, NMS Capital and TD Capital, as well as a risk arbitrage firm affiliated with Reservoir Capital. Fisher is a founder and a principal shareholder of Signal Peak Mining LLC, a joint venture with First Energy (NYSE:FE) and the Boich Group. The Company is the owner of the largest underground long-wall coalmine in the United States. Fisher is also a founder and a principal shareholder of American Energy Group, a specialty chemicals manufacturer based in Milwaukee, Wisconsin. Mr. Fisher holds a JD/MBA from Columbia University and a BS from Washington University in St. Louis.

Robert Gibbins ~ Autonomy

Robert is the Founder (2003) and Chief Investment Officer of Autonomy Capital. Prior to Autonomy, he spent 9 years as Head of Emerging Markets Proprietary Trading and as a European Government debt trader at Lehman Brothers. Robert started his career as a Fixed Income and FX derivative trader at JP Morgan. Robert received a B.S. in Economics from the Wharton School at the University of Pennsylvania.

Mike Novogratz ~ Fortress

Michael E. Novogratz is a principal and has been a member of the Board of Directors of Fortress Investment Group LLC since November 2006. Mr. Novogratz has been a member of the Management Committee of Fortress since March 2002. Mr. Novogratz is responsible for the Liquid Markets business. Prior to joining Fortress in March 2002, Mr. Novogratz spent eleven years at Goldman, Sachs & Co., where he became a partner in 1998. Mr. Novogratz held the positions of President of Goldman Sachs Latin America and the head of Fixed Income, Currencies and Commodities Risk in Asia, where he lived from 1992 to 1999. Mr. Novogratz received a B.A. from Princeton University, and served as a helicopter pilot in the U.S. Army.

Andres Drobny ~ Drobny Global Advisors

Andres Drobny is the founder of Drobny Global Advisors, a financial markets research boutique based in Manhattan Beach, California that advises a select group of hedge funds, proprietary traders, and global money managers on world markets. Before starting Drobny Global Advisors, he served as Strategist & Proprietary Trader at Credit Suisse First Boston in London and NY, and was on the Global Foreign Exchange Management Committee. Earlier, Drobny also served as Chief Economist & Head of Research for Bankers Trust Company, London. Prior to entering the financial markets in 1987, Drobny was an academic economist at the Universities of Cambridge & London and holds a PhD in Economics from King's College, Cambridge.