October 2014 “Risk-off” analysis

Jan Lundstrom

ECB BMCG meeting 27th January 2015
Volatile markets across asset classes ....

Intraday volatility in Rates, Equities, Currencies – intraday spike largest in Rates

Source: Bloomberg, Barclays Research
... 15-Oct move in Rates outsized

Rally in Rates was outsized, given the decline in stocks

Source: Barclays Research
Drivers of outsize intraday market volatility

A number of factors contributed to volatility on October 15

- Fed ending asset purchases contributing to stocks sell-off?
- Exceptionally high volumes in US Treasury trading on October 15
- US Treasury liquidity progressively withdrawn as market rallied on October 15
- Positioning: duration shorts at elevated levels
- Risk environment deteriorating in the first half of October: e.g. peripheral/core EGB spreads widening after positive price action over the summer period
- Broker dealer balance sheet contraction
Equity market reaction around Fed asset purchase programs

Pattern of stocks selling off whenever the Fed has tried to end asset purchases

Source: Bloomberg, Barclays Research
US Treasury trading volumes

TY trading volumes were the highest on record on Weds 15th Oct

Source: CME, Bloomberg, Barclays Research
US Treasury liquidity plummets after initial rally

Liquidity in 10yr Treasury measured by total size of orders in 10 levels of depth of book

Source: Nanex
US Treasury liquidity comparison – September vs. October

Liquidity in 10yr Treasury measured by total size of orders in 10 levels of depth of book

Source: Nanex

Graph showing 10 Year Treasury Liquidity Crisis 15-Oct-2014 vs 17-Sep-2014

Normal liquidity drop before 8:30 Economic News

Source: Nanex
Market positioning: Open Interest

Short positioning in Eurodollars was at an extreme

Source: Haver Analytics, Barclays Research
Market positioning: Open Interest

Eurodollars positioning: focusing on more recent data shows short covering from September onwards

Source: Bloomberg, Barclays Research
Mutual fund positioning index also points to a large underweight duration versus the benchmark.
Broker dealer balance sheets are becoming smaller, especially in relation to the size of the market.

Source: Haver Analytics, Barclays Research
Repo balance sheet availability (US Treasury repo)

Total Treasury repo volumes are trending lower, declining by around 15% between 2011 and 2014

Note: There is a definitional break in the Fed’s repo data beginning in April 2013.

Source: Federal Reserve and Barclays
Topics of discussion

1. Overall assessment of the market volatility on Oct 15
2. Reduction in Risk Inventory – for cash products focus is on balance sheet utilisation
3. Changes to market making model
4. Market structure I: ability of dealers to supply immediacy services, availability of balance sheet
5. Market structure II: automation of liquidity provision leading to less robust markets?
6. Risk of future turbulence?
   • “Perfect storm” of one-off factors (extreme positioning, record volumes, risk environment changes) unlikely to repeat frequently
   • Structural factors (reduction in risk inventory, market structure changes) likely to have an impact on liquidity provision going forward
7. Relatively quick mean reversal from extremes - a trading opportunity? An opportunity for liquidity provision?
Euro IRS 10s30s curve

January 6-7: Significant intraday volatility despite relatively moderate risk positioning and flow
Disclaimer

This document has been prepared by Barclays Bank PLC, acting through its investment bank (“Barclays”), for information purposes only. This document is an indicative summary of the terms and conditions of the securities/transaction described herein and may be amended, superseded or replaced by subsequent summaries. The final terms and conditions of the transaction and any related security will be set out in full in the applicable transaction confirmation, offering document(s), pricing supplement or binding transaction document(s).

This document shall not constitute an underwriting commitment, an offer of financing, an offer to buy or sell, or the solicitation of an offer to buy or sell any securities described herein, which shall be subject to Barclays’ internal approvals. No transaction or service related thereto is contemplated without Barclays’ subsequent formal agreement.

Barclays is acting solely as principal and not as advisor or fiduciary. Barclays does not provide, and has not provided, any investment advice or recommendation to you in relation to the transaction and/or any related securities described herein and is not responsible for providing or arranging for the provision of any general financial, strategic or specialist advice, including legal, regulatory, accounting, model auditing or taxation advice or services or any other services in relation to the transaction and/or any related securities described herein. Accordingly Barclays is under no obligation to, and shall not, determine the suitability for you of the transaction described herein. You must determine, on your own behalf or through independent professional advice, the merits, terms conditions and risks of the transaction described herein. You must also satisfy yourself that you are capable of assuming, and assume the risks of any such transaction. Neither Barclays nor any of its subsidiaries, affiliates or ultimate holding company, nor any of the subsidiaries or affiliates of such holding company (the “Barclays Group”), nor any of their respective directors, officers, employees, representatives or agents, accepts any liability whatsoever for any direct, indirect or consequential losses (in contract, tort or otherwise) arising from the use of this document or its contents or reliance on the information contained herein.

Barclays does not guarantee the accuracy or completeness of information which is contained in this document and which is stated to have been obtained from or is based upon trade and statistical services or other third party sources. Any data on past performance, modelling, scenario analysis or back-testing contained herein is no indication as to future performance. No representation is made as to the reasonableness of the assumptions made within or the accuracy or completeness of any modelling, scenario analysis or back-testing. All opinions and estimates are given as of the date hereof and are subject to change. The value of any investment may fluctuate as a result of market changes. The information in this document is not intended to predict actual results and no assurances are given with respect thereto.

Barclays is a full service securities firm engaged in a wide range of businesses and from time to time, in the ordinary course of its business, Barclays and/or other parts of the Barclays Group may hold long or short positions and trade or otherwise effect transactions for their own account or the account of their customers in the securities referred to herein and/or the debt or equity securities, assets or loans (or any derivatives thereof) of the companies referred to herein. Additionally, Barclays and/or other parts of the Barclays Group may have investment and commercial banking, lending, asset management and other relationships with parties which are or may become involved in the transactions referred to herein and/or which may have interests which could potentially conflict with the interests of the recipient hereof. Barclays and/or other parts of the Barclays Group have in place policies and procedures to restrict the flow of information and to identify, consider and manage such potential conflicts of interest. Accordingly, you acknowledge and agree that no part of the Barclays Group is required to restrict its activities as a result of the provision of this document, and that all parts of the Barclays Group may undertake any activities without further consultation with or notification to you. Barclays shall not be required to account to you for any revenue or profits obtained in connection with any activities of the Barclays Group as referred to herein.

Barclays’ research analysts and research departments are independent from Barclays’ investment banking division and are subject to certain regulations and internal policies. Barclays’ research analysts may hold and make statements or investment recommendations and/or publish research reports with respect to any company referred to herein, the transactions contemplated herein or any person involved therein or related thereto that differ from or are inconsistent with the views or advice communicated by Barclays’ investment banking division.

Barclays offers premier investment banking products and services to its clients through Barclays Bank PLC. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange. Barclays Bank PLC is registered in England No. 1026167 with its registered office at 1 Churchill Place, London E14 5HP. Copyright Barclays Bank PLC, 2014 (all rights reserved).

This document is confidential, and no part of it may be reproduced, distributed or transmitted without the prior written permission of Barclays.