

Global Rates Strategy

How Are Different Client Types Positioned Globally?

- The world has moved on considerably in the two months since we published our last snapshot when yields were close to their peak. Most importantly, the pendulum of tapering expectations has swung to later rather than sooner, aided by US shutdown noise.
- We look at how, and to what extent, investors have changed their positioning, divergences in positioning between different investor groups, and aggregate positioning in individual countries. Specifically, we examine positioning across hedge funds, real money and central banks in the following markets: US, Japan, Germany, France, Italy, Spain, Ireland and the UK.
- The clearest and most significant change in positioning is in the US, which has become considerably less short and less consensual (See Figure 1 below). Both hedge funds and Asian investors have swung from short to long.
- For more analysis, additional countries, and for positioning by investor type please see the following pages.

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Figure 1. Reversal of short positions in the US. Positioning more balanced than previously.

Positioning in: US								
Client type		Very Long	Long	Small long	Neutral	Small short	Short	Very short
HEDGE FUNDS			X					
CENTRAL BANKS						X		
REAL MONEY	US					X		
	Germany & France					X		
	EMU							
	Italy & Spain					X		
	Japan				X			
	ASIA					X		
	Asia-ex Japan					X		
UK						X		

Source: Citi Research

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Getting a Fix on Global Positioning

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The world has moved on considerably in the two months since we published our last snapshot when yields were close to their peak. Since then yields have retraced a third of their move higher, which began with Bernanke's comments in May. We have seen the anticipated decision on the consumption tax hike in Japan, postponement of the US debt ceiling and the pendulum of expectations swing towards later tapering. The latter is especially important with markets currently in a topsy-turvy world where (economic) bad news is good news (for asset prices).

Below we look at what positioning looks like now, and where and how it has changed. We examine the differences in positioning between different investor types, and highlight imbalances between positioning in certain countries¹. Through this we can get an insight into how the ongoing need for yield is expressing itself in an environment where yield levels are likely to be broadly range-bound, systemic risk appears lower than it has been in a long time², and the green shoots of growth are starting to appear.

US and Japan

US – hedge funds and Japanese investors now long

There has been a clear reduction in shorts in the US (Figure 2). Previously, the concentration of shorts and absence of longs in the US pointed to asymmetric sensitivity to weak data. That has now disappeared: the previous unanimous short positioning is now much more balanced, with hedge funds and Japanese investors currently long. These two groups also saw the biggest swings in their positioning.

Figure 2. Reversal of short positions in the US. Overall positioning much more balanced. Hedge funds and Asian investors have been the swing players.

Positioning in: US		Very Long	Long	Small long	Neutral	Small short	Short	Very short
Client type								
HEDGE FUNDS			X					
CENTRAL BANKS						X		
REAL MONEY	US					X		
	Germany & France					X		
	Italy & Spain				X			
	Japan		X					
	Asia-ex Japan				X			
	UK					X		

Source: Citi Research

Figure 3. Japan: hedge funds have gone long and UK real money has reversed its short.

Positioning in: JAPAN		Very Long	Long	Small long	Neutral	Small short	Short	Very short
Client type								
HEDGE FUNDS			X					
CENTRAL BANKS					X			
REAL MONEY	US					X		
	Germany & France				X			
	Italy & Spain					X		
	Japan		X					
	Asia-ex Japan				X			
	UK		X					

Source: Citi Research

Japan – hedge funds (and UK real money) are the main international long

Hedge funds are also the main long in Japan (Figure 3), but the largest swing was in UK real money which moved from short to small long, as Abe finally made his decision on the consumption tax hike³.

¹ The results are based directly on simultaneous responses from Citi's global network of salespeople. Because some areas overlap, e.g., coverage by account type and geography, and some important subcategories need to be combined, e.g., banks and insurers, judgment has been necessary in summarizing the results. Nevertheless it gives a good picture of current positioning - without the long lags, holes and other practical problems that bedevil global client surveys. The aim of the exercise is to identify consensual positions and give some idea of the relative strength of views being expressed. The analysis should also help guard against overweighting individual snippets of flow information, and help fill in parts of the global picture that are difficult to see clearly from any one region.

² For example, the ECB's indicator of systemic stress is at its lowest levels since it began in 1999.

³ It remains to be seen whether that is compatible with the inflation target. We are not at all optimistic.

UK + core and peripheral Europe

UK – positioning remains light and balanced

Positioning in the UK remains both light and balanced (Figure 4), with domestic and Japanese shorts offsetting small long positions of hedge funds and central banks.

Core – imbalance of longs over shorts

Position changes in the core have been more significant (Figure 5): hedge funds (and UK investors) have reversed their shorts, and central banks have gone longer. Japanese investors remain long. The preponderance of long positions in liquid core Europe, and the absence of shorts, is striking, and points to possible vulnerability. However, this positioning-related vulnerability seems greater in France, given that German and French domestics are collectively long France but *short* Germany⁴.

Figure 4. Positioning in the UK remains both moderate and balanced.

Positioning in: UK									
Client type		Very Long	Long	Small long	Neutral	Small short	Short	Very short	
HEDGE FUNDS				X					
CENTRAL BANKS				X					
REAL MONEY	US				X				
	Germany & France				X				
	Italy & Spain				X				
	Japan					X			
	Asia-ex Japan			X					
	UK					X			

Source: Citi Research

Figure 5. Increased appetite for core Europe from hedge funds, central banks, and UK investors. Imbalance of long positioning.

Positioning in: CORE (Gmy & Fce)									
Client type		Very Long	Long	Small long	Neutral	Small short	Short	Very short	
HEDGE FUNDS			X						
CENTRAL BANKS			X						
REAL MONEY	US				X				
	Germany & France			X					
	Italy & Spain				X				
	Japan		X						
	Asia-ex Japan					X			
	UK			X					

Source: Citi Research

In contrast to the core, positioning in the periphery has moved towards shorts.

Figure 6. Clear negative shift in sentiment towards Italy across all client types. Investors have reduced long positions, moved to neutral, or gone slightly short. Domestics remain the only large position.

Positioning in: ITALY									
Client type		Very Long	Long	Small long	Neutral	Small short	Short	Very short	
HEDGE FUNDS				X					
CENTRAL BANKS					X				
REAL MONEY	US				X				
	Germany & France			X					
	Italy & Spain	X							
	Japan					X			
	Asia-ex Japan				X				
	UK					X			

Source: Citi Research

Figure 7. UK real money has reversed its small long in Spain (and Italy) while Japanese investors remain short. Risk is light otherwise.

Positioning in: SPAIN									
Client type		Very Long	Long	Small long	Neutral	Small short	Short	Very short	
HEDGE FUNDS				X					
CENTRAL BANKS					X				
REAL MONEY	US				X				
	Germany & France			X					
	Italy & Spain	X							
	Japan						X		
	Asia-ex Japan				X				
	UK					X			

Source: Citi Research

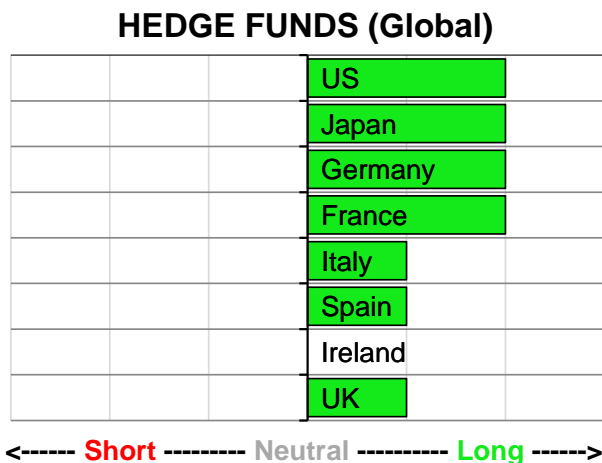
⁴ The aggregation in Figure 5 masks this difference.

Positioning by investor type

Hedge fund positioning

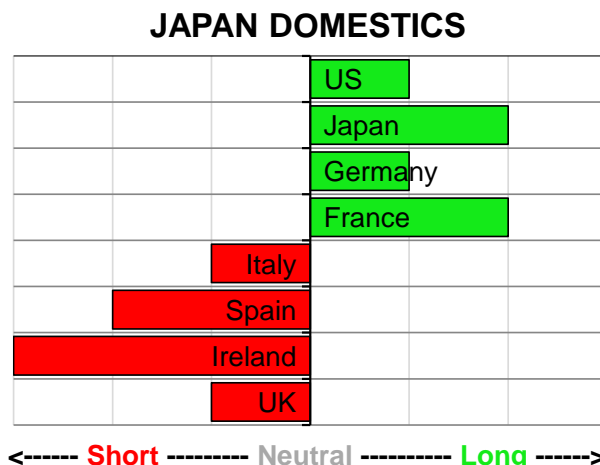
The figures above show positioning by country, then client type. However, you can obviously reverse this priority to show positioning by investor type, to give an idea of the different profiles of risk appetite. When you do this you see hedge funds long across the board (Figure 8), and, by implication, taking little cross-market risk.

Figure 8. Hedge funds are generally long and not taking major cross-market risk



Source: Citi Research

Figure 9. Clear preference for France and negative view on peripherals (and the UK) among Japanese investors.



Source: Citi Research

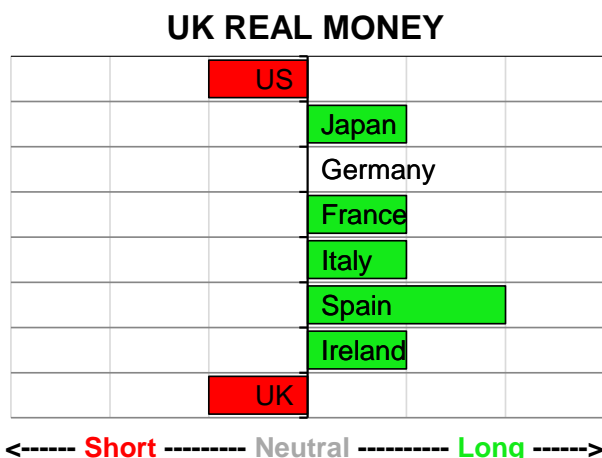
Japanese positioning

Japanese investors continue to demonstrate their preference for France and are positioned for negative news in peripherals (and the UK) – see Figure 9 above.

UK domestics and core Europe domestic positioning

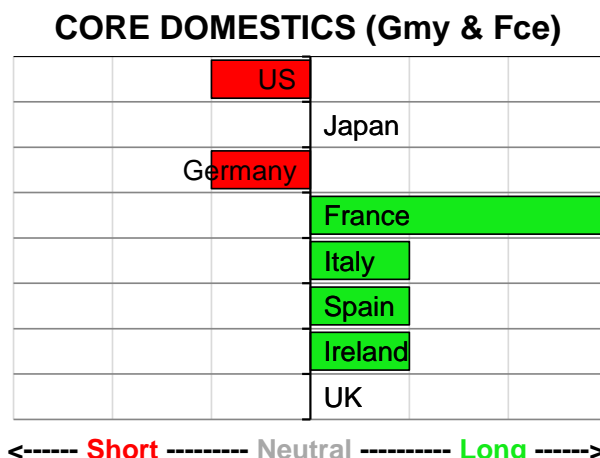
UK real money is small short the US and UK, neutral Germany, but long everything else (Figure 10), and Spain in particular. Domestics in core Europe are also short the US, but also Germany. They too are long peripheral risk, but their main long is in France (Figure 11).

Figure 10. UK real money are short the US and UK, and long Spain



Source: Citi Research

Figure 11. Core domestics are short the US and Germany, and long France and peripherals.



Source: Citi Research

Summary

Split by country

US: Positioning in the US is no longer unanimously short and is now much more balanced, with hedge funds and Japanese investors now long.

Japan: Hedge funds are also the main long in Japan, but the largest swing was in UK real money which moved from short to (small) long.

UK: Positioning in the UK remains both light and balanced, with domestic and Japanese shorts offsetting small long positions of hedge funds and central banks

Core Europe: Hedge funds (and UK investors) have reversed their shorts, and central banks have gone longer. Japanese investors remain long. There is a notable absence of significant shorts.

Periphery: Longs have been scaled back, and Asian and UK investors have moved small short.

Split by investor type

Hedge funds: Positioned to benefit from lower yields

Japanese investors: Positioned for negative news in peripherals (and the UK), and continuing to demonstrate their preference for France.

UK real money: Small short the US and UK, neutral Germany, but long everything else.

Domestics in core Europe: short the US and Germany; long peripheral risk but their main long is in France.

Conclusions

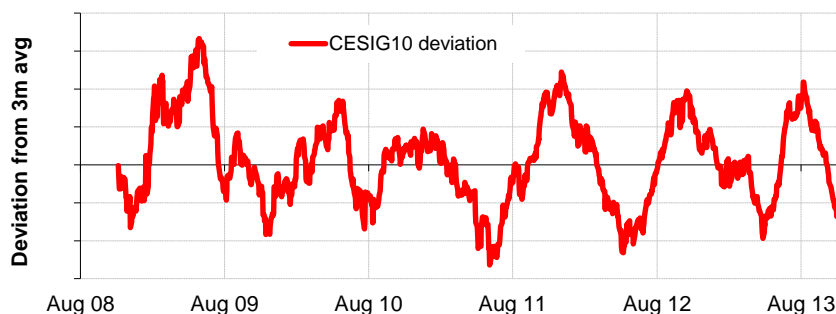
Tapering, positioning, and US yields

The tapering expectations pendulum has swung towards later rather than sooner, but the swing in positioning has been limited to hedge funds and Japanese investors. While the previously unanimous short US positioning that was creating an asymmetric sensitivity to weak data has not turned into unanimous long positions, it is worth keeping a close eye on these two investor groups as they are very significant and likely to drive the marginal flow.

Restricted scope for economic surprises to fuel another significant leg lower in yields

Even ignoring their positioning, we would sound a word of caution on adding to bullish risk here: using economic surprise indices as a momentum indicator (Figure 12) points to limited scope for data to surprise on the downside from here.

Figure 12. Deviation of G10 Economic Surprise Index from its 3m average is close to its lows



Source: Citi Research

Positioning suggests waning risk appetite for peripherals at current levels

While there has been a drift towards longs in the US and core Europe, there has been an equally clear drift away from longs in peripheral space. Spreads may tighten further, but positioning seems to reflect a less sanguine view of the risk/reward given how far they have already come.

Appendix A-1

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