Ineichen Research and Management

Update for onscreen viewing

Risk Management Research

Fed recommends hedging too

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www.ineichen-rm.com

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"There are a number of significant downside risks to the economic outlook, and hence it may well be appropriate to insure against adverse shocks …"
—Janet Yellen, Vice Chair of the Board of Governors of the Fed, 6 June 2012

Summary

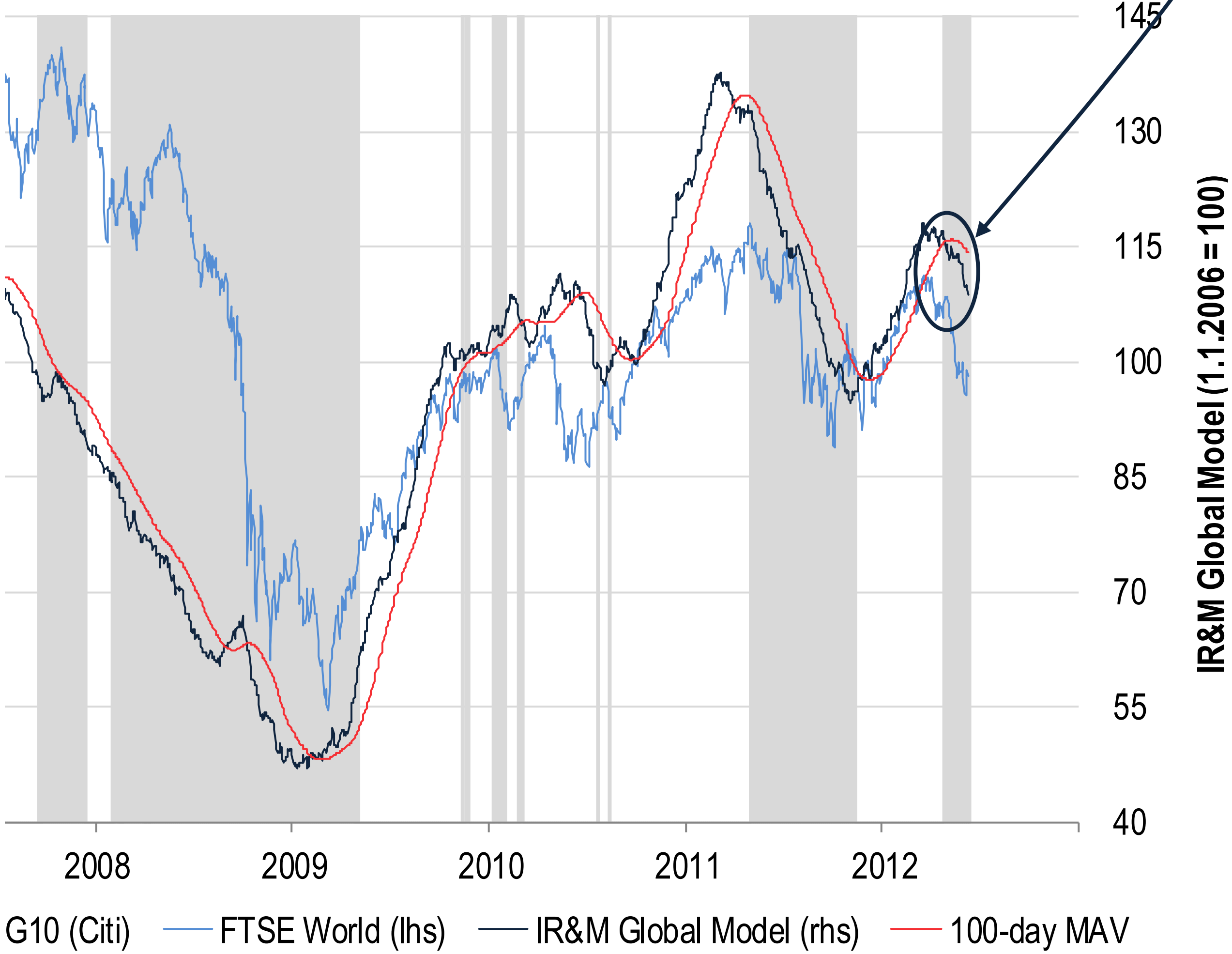
Changes vs last update.

08 Jun 12	Fundamentals: IR&M Models: Percentile (2006-)	Change*** (31 May 12)	Rank	Direction*	Average (100-day)	Above average?	Surprises**	Remarks	Technicals: Moving averages: 50D	200D	50D> 200D?
Global	68	-3.0		Falling	Falling	No	Negative	Declining.	Falling	Falling	Yes
US	75	-3.0	1	Falling	Rising	No	Negative	Declining.	Falling	Rising	Yes
Europe	48	-2.7	5	Falling	Falling	No	Negative	Declining.	Falling	Falling	No
Germany	58	-5.4	4	Falling	Rising	No	Negative	Declining.	Falling	Rising	Yes
France	47	-0.7	6	Falling	Falling	No	Negative	Declining.	Falling	Falling	No
Italy	41	3.4	7	Rising	Falling	No	Negative	Declining. Small uptick though.	Falling	Falling	No
UK	67	-1.8	3	Falling	Falling	Yes	Negative	Declining. Model just a tick above average.	Falling	Rising	Yes
Switzerland	39	-2.0	8	Falling	Rising	Yes	Positive	Safe harbour, PMI same as Europe though.	Falling	Rising	Yes
Japan	75	-4.6	2	Falling	Rising	No	Negative	Declining. JPY too strong.	Falling	Falling	Yes
China	14	0.0	9	Falling	Rising	No	Negative	At an inflection point.	Falling	Falling	No

Notes: * Direction: average last five days versus previous five-day average; ** Surprises are from Citigroup except Germany (which is our own). Surprises for France and Italy are for the Eurozone as a whole.
*** Change in percentile points relative to date shown in brackets.

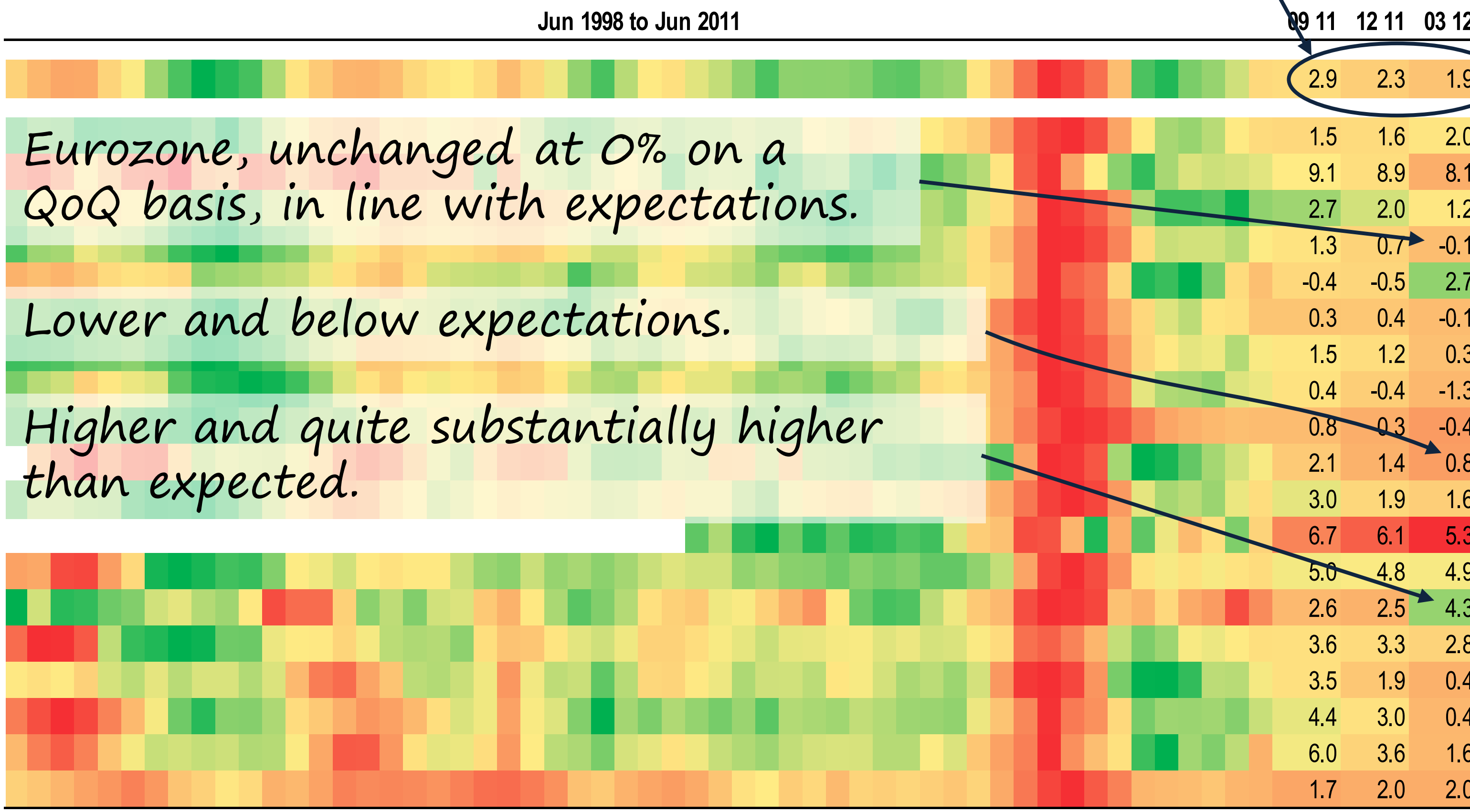
Global economy: declining

It's all very clear now: things economic are deteriorating. Surprises have been negative since 23.4.12 while our global model had crossed moving average on 26.4.12. This means now is not the time to be courageous (ie, long-only) but conservative (ie, hedged). It's better to be safe than sorry. No one knows how long the down draft will last; no one.



Source: IR&M, Bloomberg. Model consists of two weekly and 19 monthly indicators and is designed to give a data point nearly every day. The model is work in progress.

Global economic growth: declining



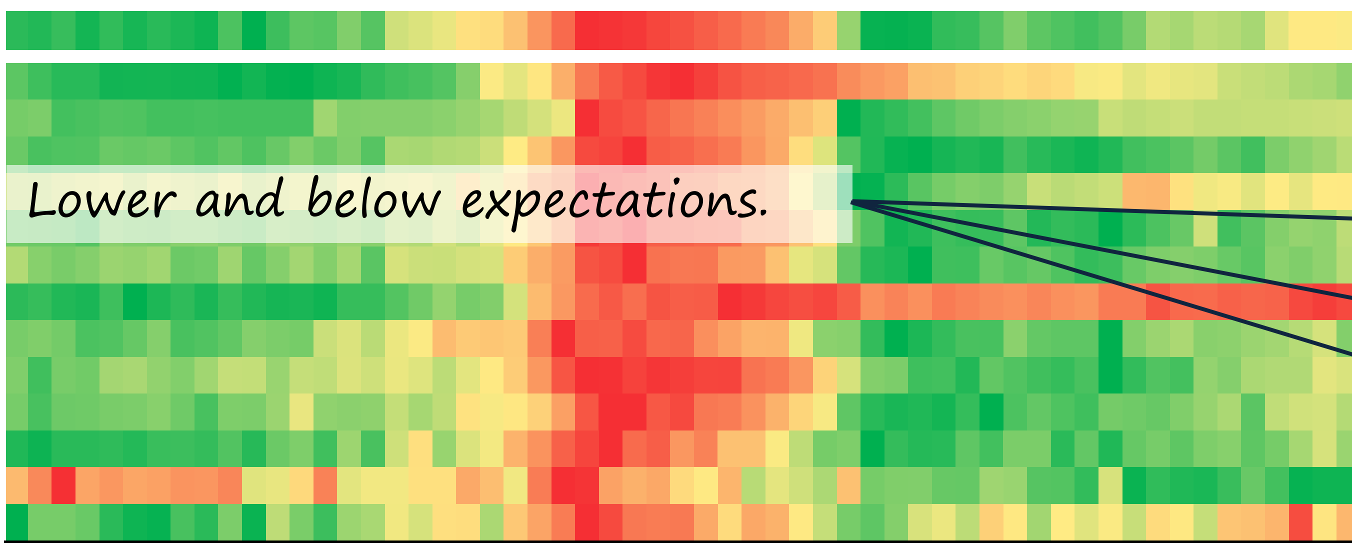
	09 11	12 11	03 12
Average	2.9	2.3	1.9
US	1.5	1.6	2.0
China	9.1	8.9	8.1
Germany	2.7	2.0	1.2
Eurozone	1.3	0.7	-0.1
Japan	-0.4	-0.5	2.7
UK	0.3	0.4	-0.1
France	1.5	1.2	0.3
Italy	0.4	-0.4	-1.3
Spain	0.8	0.3	-0.4
Brazil	2.1	1.4	0.8
Canada	3.0	1.9	1.6
India	6.7	6.1	5.3
Russia	5.0	4.8	4.9
Australia	2.6	2.5	4.3
South Korea	3.6	3.3	2.8
Taiwan	3.5	1.9	0.4
Hong Kong	4.4	3.0	0.4
Singapore	6.0	3.6	1.6
Switzerland	1.7	2.0	2.0

Source: IR&M, Bloomberg. Notes: Based on real GDP, SAAR (seasonally adjusted annual rate). The average is equally weighted.

Industrial output*: declining

We don't like old data that much. However, it might serve as a confirmation of the trend the newer data has been pointing towards the last couple of weeks: down.

Nov 2006 to Dec 2011



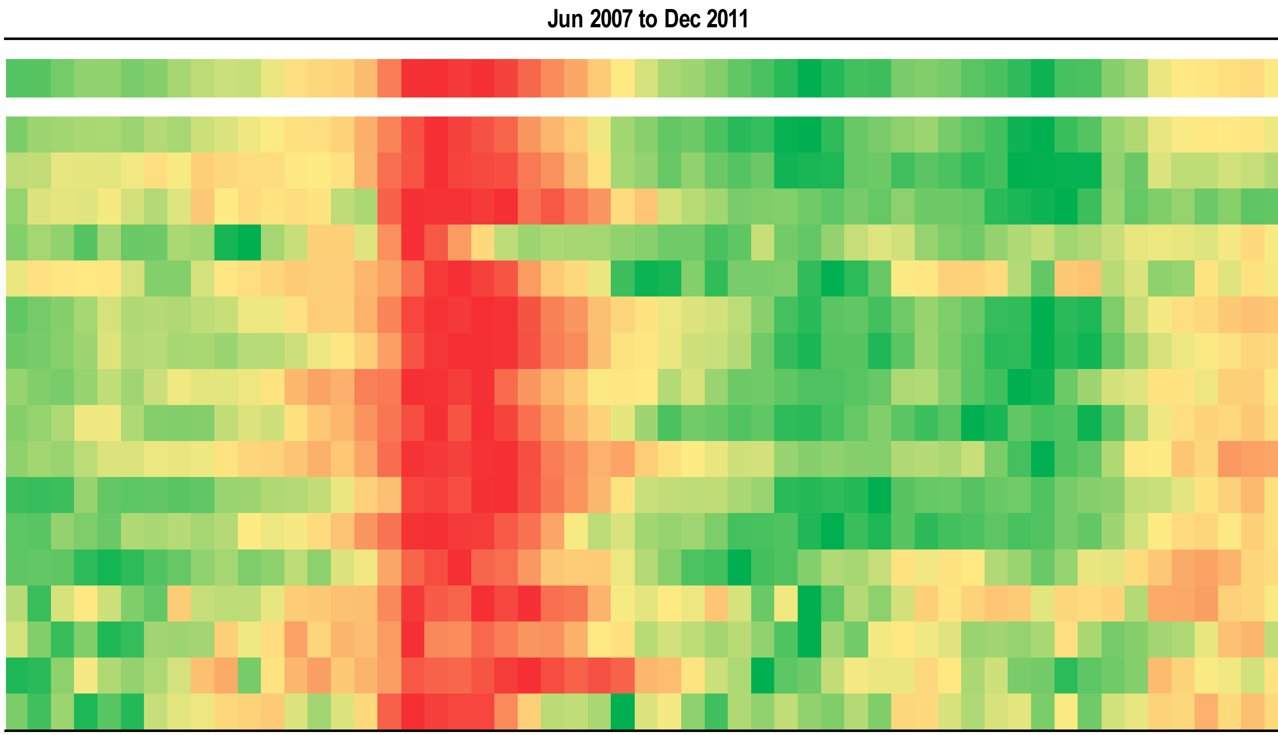
Lower and below expectations.

	02 12	03 12	04 12
Average	54.3	55.4	53.1
US	78	75	81
China	45	46	43
Eurozone	64	62	n.a.
Japan	56	74	73
Germany	59	63	58
France	63	65	n.a.
UK	5	4	n.a.
Netherlands	51	66	61
Sweden	41	42	43
Italy	51	54	45
Spain	64	56	54
South Korea	89	100	91
India	42	14	n.a.

Source: IR&M, Bloomberg. Note: Figures are shown in percentiles, ie, high and low were normalised to 100 and 0. * Generally a lagging indicator.

PMI: below 50 and falling

India's PMI rose to 54.7, its highest level in 3 months, with business expectations rising to a 15 month high.



	Jan	Feb	Mar	Apr	May
Average	51.0	52.2	51.5	49.4	48.2
Global PMI (JPM)	51	51	51	51.4	50.6
US: ISM	54	52	53	54.8	53.5
US: Chicago	60	64	62	56.2	52.7
China	51	51	53	53.3	50.4
Japan	51	51	51	50.7	50.7
Eurozone	49	49	48	45.9	45.1
Germany	51	50	48	46.2	45.2
UK	52	52	52	50.2	45.9
France	49	50	47	46.9	44.7
Italy	47	48	48	43.8	44.8
Switzerland	47	49	51	46.9	45.4
Sweden	51	50	50	50.2	49.0
Brazil	51	51	51	49.3	49.3
Australia	52	51	50	43.9	42.4
New Zealand	51	58	54	48.0	n.a.
South Africa	53	58	55	53.7	53.6
Singapore	49	50	50	49.7	50.4

Above 50.

Source: IR&M, Bloomberg. Notes: PMI is a diffusion index. A figure below 50 means economy is contracting. The global PMI is a composite by JPM. The average is equally weighted and excludes the JPM composite.

PMI services: below 50 and falling

The HSBC Service Sector PMI improved to 54.7 in May, a new 19 month high. Russia's service sector PMI rose to 54.9 from a 19 month low of 52.6.

For all practical purposes, in line with (flash) estimates.

Jun 2007 to Dec 2011

	Jan	Feb	Mar	Apr	May
Average	53.1	52.2	51.8	49.2	49.0
Gl. Services PMI	55	56	55	52.0	52.5
US: Non-Man	57	57	56	53.5	53.7
China	56	57	58.0	56.1	55.2
Eurozone	50	49	49	46.9	46.7
Germany	54	53	52	52.2	51.8
UK	56	54	55	53.3	53.3
France	52	50	50	45.2	45.1
Italy	45	44	44	42.3	42.8
Sweden	54	54	53	48.6	47.7
Australia	52	47	47	39.6	43.5
Brazil	55	57	54	54.4	49.7

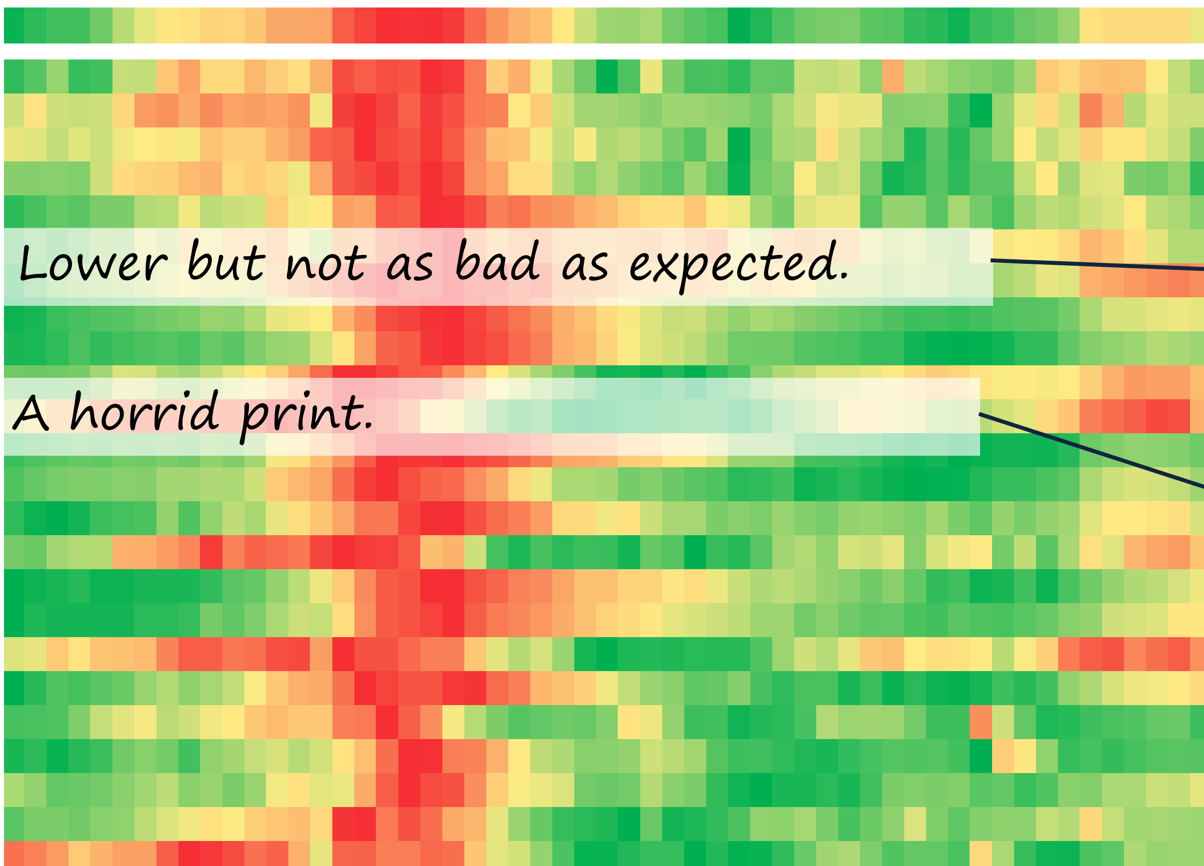
Slightly higher and above expectations.
A small fall was expected.

Lower.

Source: IR&M, Bloomberg. Notes: PMI is a diffusion index. A figure below 50 means economy is contracting. The Gl. Services PMI is a composite by JPM. The average is equally weighted and excludes the JPM composite.

Business sentiment: declining

Jul 2007 to Jan 2012



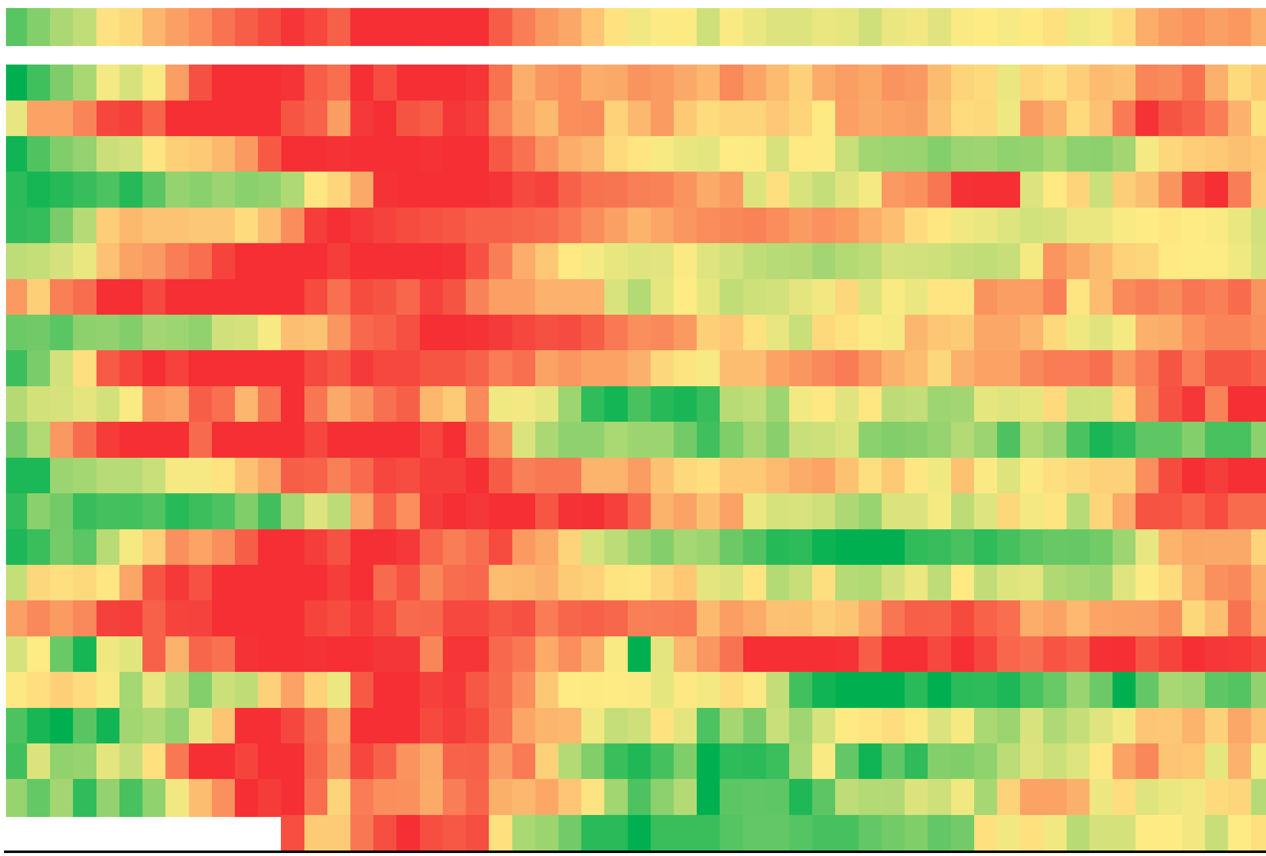
Lower but not as bad as expected.

A horrid print.

	Feb	Mar	Apr	May	Jun
Average	65.2	68.2	66.6	60.5	60.1
US: Empire State	80	81	60	76	n.a.
US: Philadelphia Fed	64	67	62	44	n.a.
US: Richmond Fed	87	68	78	63	n.a.
US: Dallas Fed	93	85	68	66	n.a.
US: AIM	81	81	89	88	n.a.
US: NFIB	68	58	69	n.a.	n.a.
EZ: Sentix	37	41	33	21	16
EZ: Economic	58	58	54	48	n.a.
EZ: Business	70	68	63	58	n.a.
China	36	33	26	n.a.	n.a.
Germany: ZEW Exp.	57	71	72	61	n.a.
Germany: IFO Climate	82	83	83	73	n.a.
Germany: IFO Exp.	74	75	75	69	n.a.
UK (EC)	58	53	61	52	n.a.
UK (Lloyds)	51	78	74	31	n.a.
France	56	68	61	56	n.a.
Italy	48	48	44	37	n.a.
Switzerland	45	58	60	56	n.a.
Sweden	51	69	68	67	n.a.
Japan (ESRI)	92	91	95	87	n.a.
Japan: Small biz	77	90	85	84	n.a.
South Korea	59	63	65	73	67
Australia	63	66	68	n.a.	n.a.
New Zealand	80	85	87	79	n.a.

Source: IR&M, Bloomberg. Note: Figures are shown in percentiles. The average is equally weighted.

Consumer sentiment: stabilising

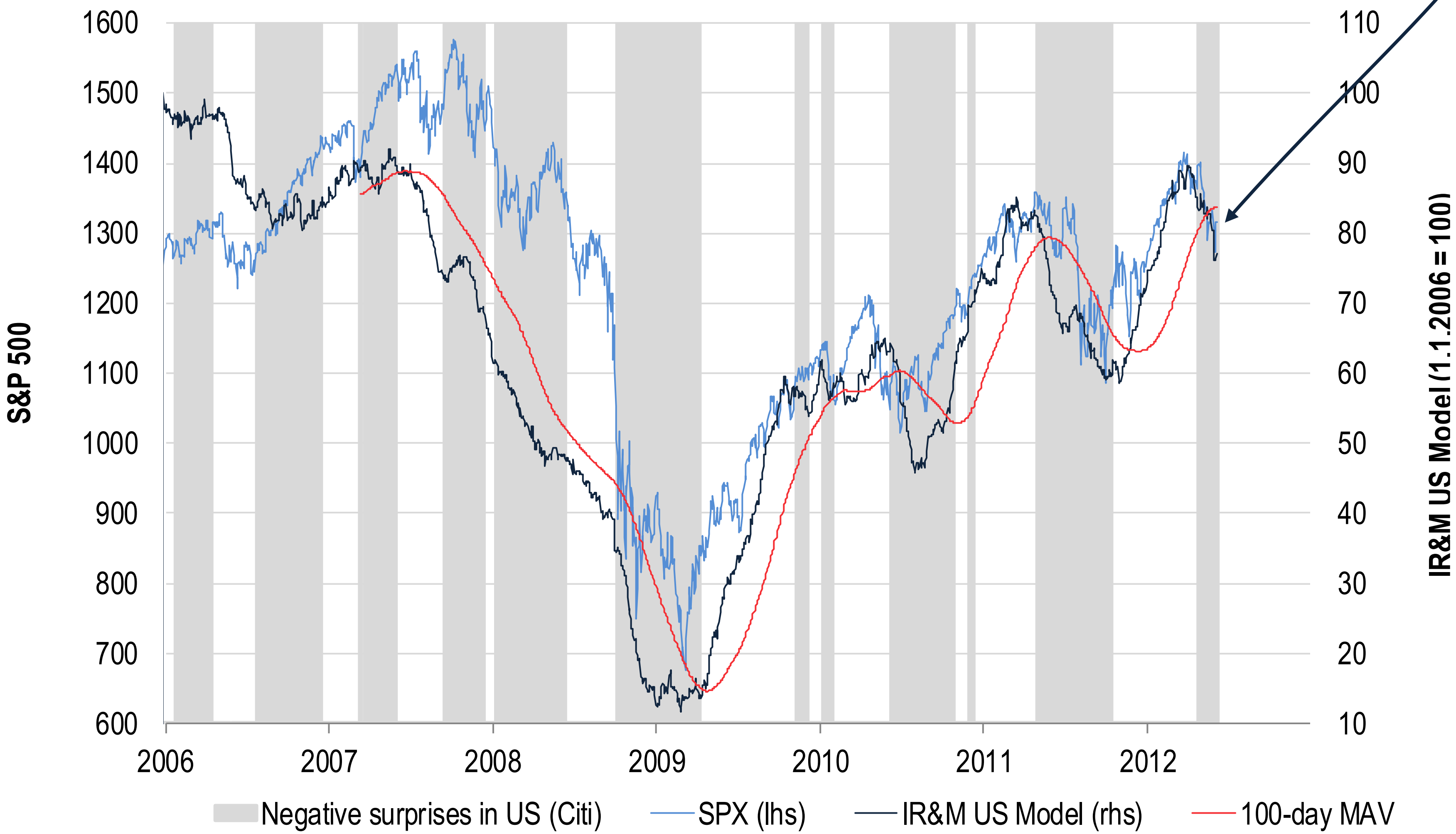


	Feb	Mar	Apr	May	Jun
Average	40.6	43.8	45.9	45.5	45.5
US: Conf Board	53	51	50	46	n.a.
US: Michigen	56	60	60	68	n.a.
Eurozone	42	45	43	45	n.a.
China	48	18	36	n.a.	n.a.
Germany	64	64	62	61	61
Japan	58	66	65	n.a.	n.a.
UK: GfK	27	22	22	27	n.a.
UK: Lloyds TSB	31	45	44	n.a.	n.a.
France	14	31	38	41	n.a.
Italy	14	27	0	0	n.a.
Spain	61	50	51	38	n.a.
Netherlands	2	0	13	2	n.a.
Switzerland	15	30	41	n.a.	n.a.
Sweden	40	47	55	58	n.a.
Denmark	46	63	66	63	n.a.
Ireland	38	46	50	n.a.	n.a.
Greece	0	7	8	13	n.a.
Brazil	83	94	100	95	n.a.
Canada	43	51	n.a.	n.a.	n.a.
Australia	49	38	35	36	n.a.
New Zealand	58	54	62	62	n.a.
South Korea	53	56	64	67	n.a.

Source: IR&M, Bloomberg. *Note: Figures are shown in percentiles, ie, high and low were normalised to 100 and 0. The average is equally weighted.

US economy: declining

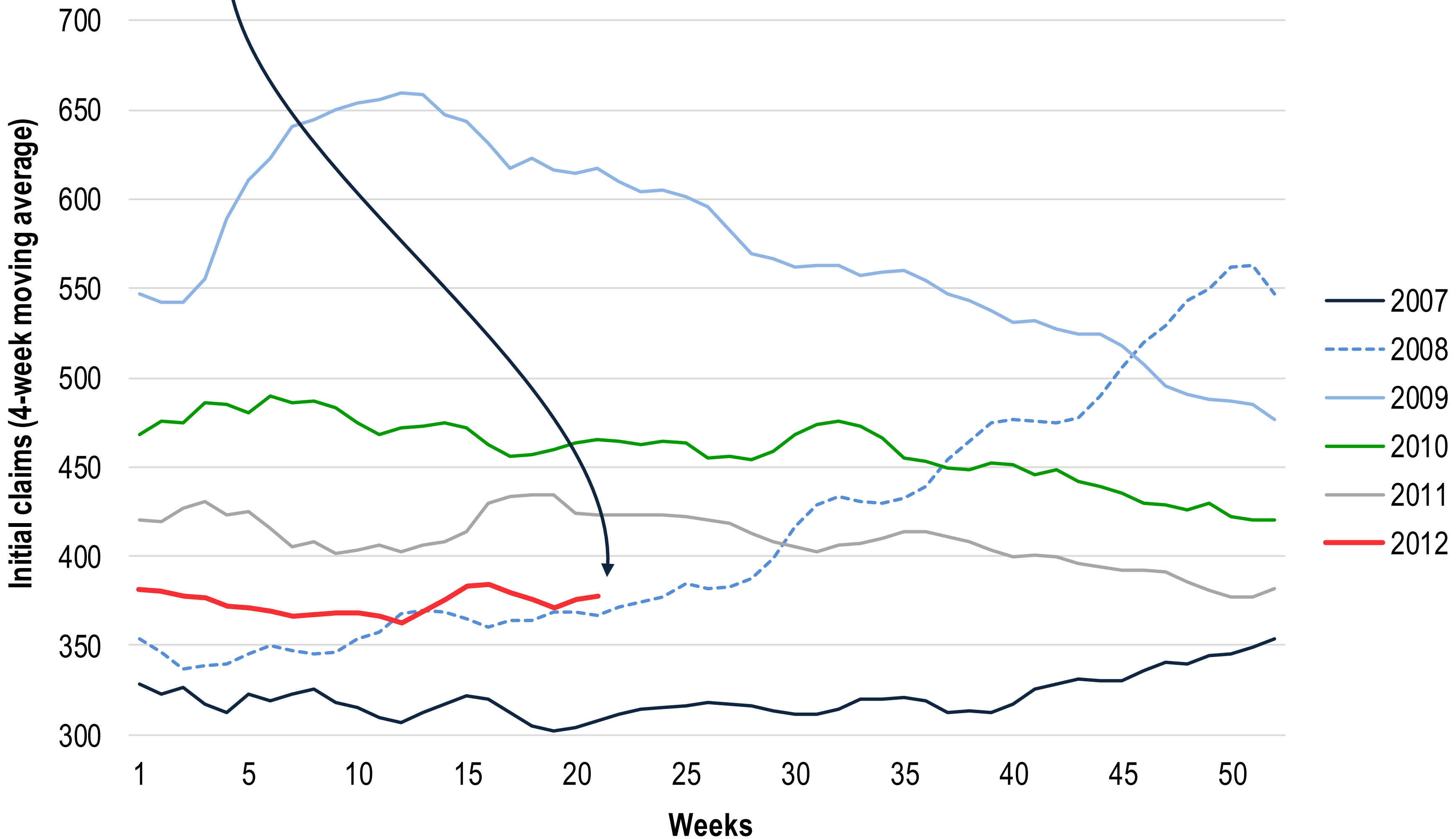
Surprises have been negative since 25.4.



Source: IR&M, Bloomberg. Note: Model consists of three weekly and 15 monthly indicators and is designed to give a data point nearly every day.

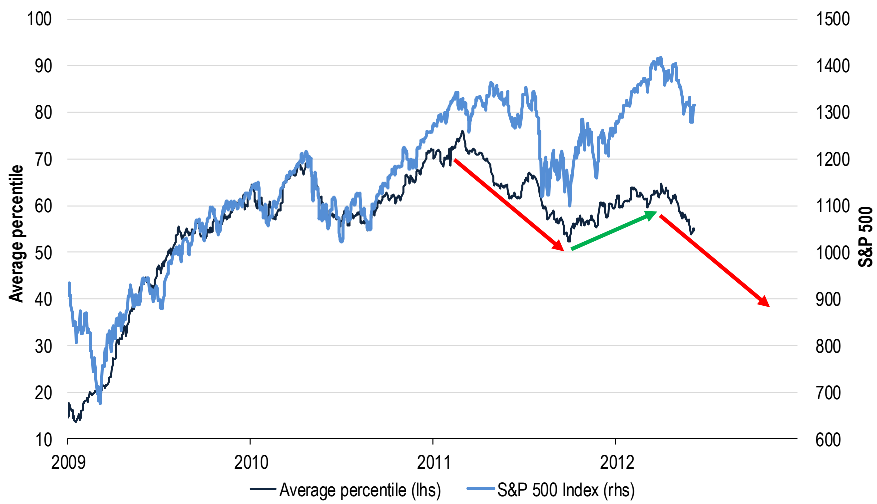
Initial jobless claims: stable

Small uptick but not yet an alarming reversal in trend. Although the red line does somewhat resemble 2008, does it not?



Source: IR&M, Bloomberg. Note: Graph shows 4-week moving averages per calendar year.

US high frequency indicators: falling



This table worked reasonably well during 2011. The average percentile figure has been falling recently. The trend is down then; until the authorities (via the Fed) step in and announce QE3 or something to that effect that is.

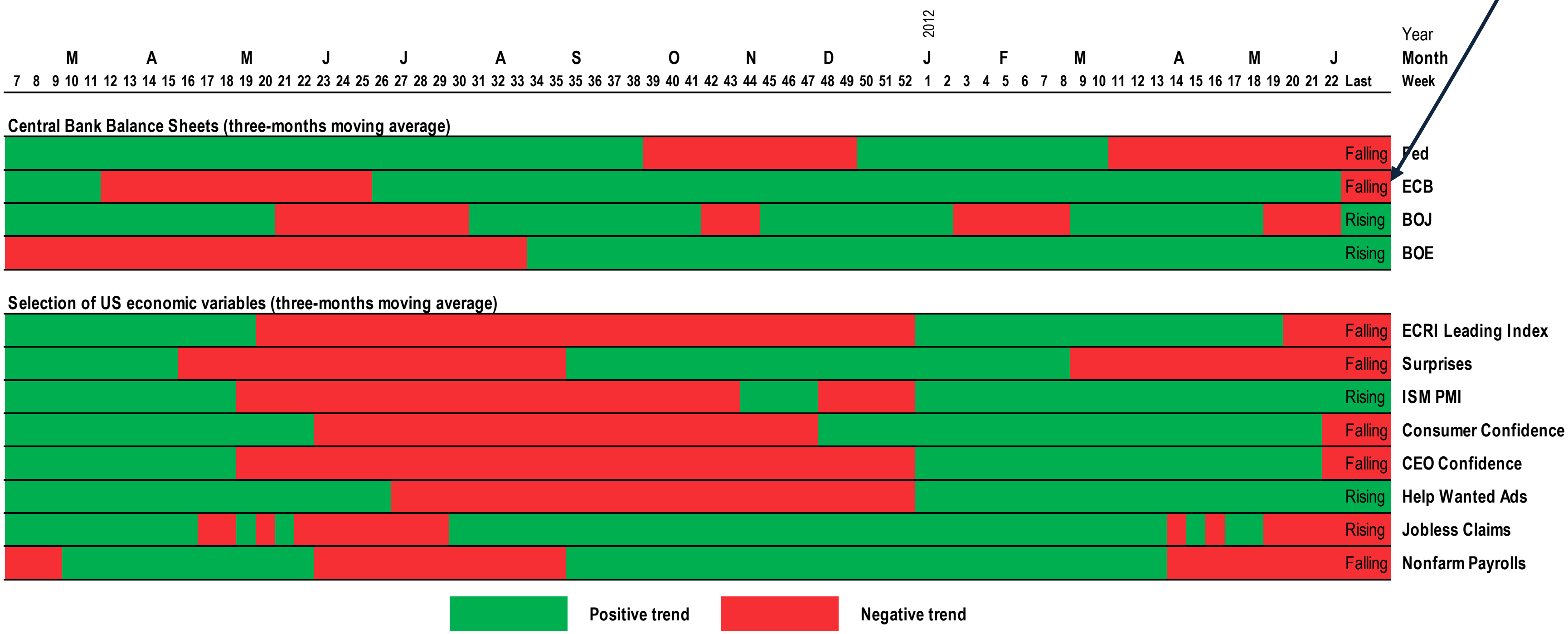
Small uptick.

	2007-			Feb				March					April				May				June	
Economic proxy	High	Low	Median	W4	W5	W6	W7	W8	W9	W10	W11	W12	W13	W14	W15	W16	W17	W18	W19	W20	W21	W22	Last
Average percentile	76	9	61	61	64	63	62	63	61	60	62	63	62	64	63	61	62	61	59	58	57	54	55
US Surprise Index	98	-141	6	65	84	73	65	58	45	39	33	27	19	7	15	5	-8	-23	-24	-25	-25	-54	-49
US Yield curve (10-2Y)	291	-19	183	168	169	171	171	167	170	171	194	188	188	174	172	170	168	162	158	143	145	121	131
ECRI Leading (Growth)	28	-30	0	-6.3	-4.9	-4.0	-3.8	-3.6	-3.0	-2.5	-1.7	-0.6	0.3	1.3	1.8	1.2	0.6	0.1	0.0	0.4	0.1	-0.6	-0.6
Bloomberg Cons Comfort	2	-54	-43	-46	-45	-42	-40	-38	-39	-37	-34	-35	-35	-31	-33	-31	-36	-38	-40	-44	-42	-39	-38
Cons Discret vs. Staples	1.16	0.57	0.93	0.99	1.00	1.00	1.00	1.00	1.01	1.01	1.01	1.02	1.01	1.01	1.02	1.00	1.03	1.01	1.00	0.96	0.98	0.96	0.98
Aruoba Diebold Scotti	0.86	-4.03	-0.23	0.19	0.15	0.07	-0.04	-0.16	-0.30	-0.39	-0.43	-0.39	-0.28	-0.13	0.00	0.07	0.07	-0.01	-0.09	-0.13	-0.15	-0.14	-0.13
US Jobless claims	667	282	399	372	381	371	361	362	373	374	363	364	363	362	388	389	392	368	370	372	373	389	377
US chain store sales, YoY	5.5	-2.5	2.6	2.8	3.9	3.5	2.8	3.2	2.7	1.7	2.3	3.3	2.7	4.2	4.5	3.2	3.6	4.2	3.3	4.5	3.8	2.9	2.8
CRB RIND	638	316	478	548	550	548	544	547	547	546	548	542	540	538	540	536	543	532	530	522	515	510	511
Copper	463	127	335	389	390	386	371	386	390	386	388	381	383	380	363	370	382	372	365	347	345	331	329
Container Ship Index	1022	237	517	394	390	388	386	384	383	386	388	389	390	389	390	394	397	400	405	408	414	415	416

Source: IR&M, Bloomberg. Table shows eleven variables that are of higher frequency and supposedly have predictive power for the US (and or global) economic cycle.

US economy: health check

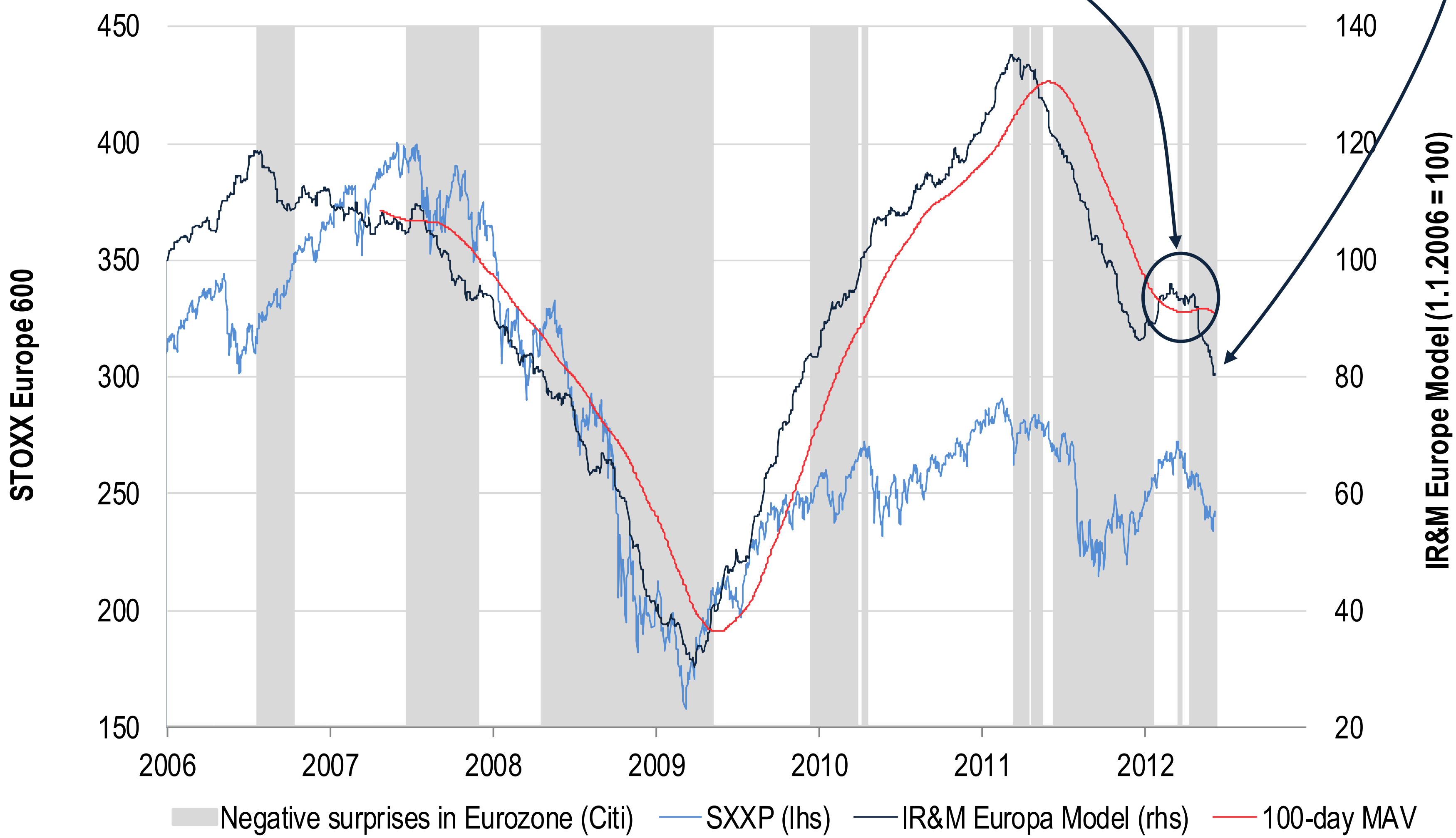
This is odd. ECB balance sheet shrinking? Who's going to buy all these PIIGS bonds? If the bureaucrats have their way, it's banks (who require the ECB's life line), insurers, and pension funds; for the time being. If things get tougher, more drastic measures will need to be enforced. (Note that the one-month average is rising.)



Source: IR&M, Bloomberg. Table shows three-months moving average of four main central bank's balance sheets as well as eight economic variables that have trending characteristics. Surprise index from Citigroup. Consumer confidence, CEO confidence, Help wanted ads from Conference Board.

Europe: declining

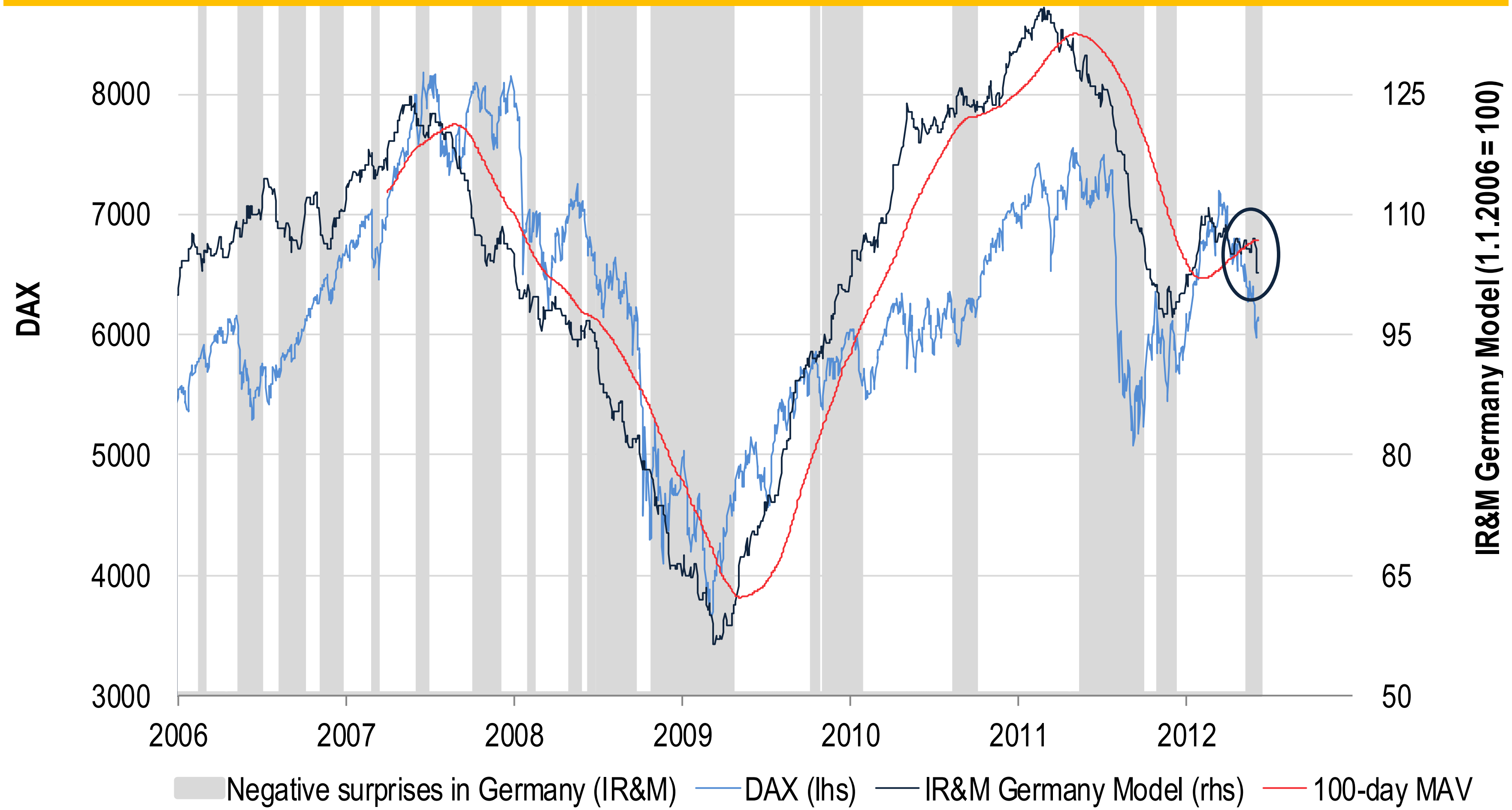
With the benefit of hindsight we can now identify the hick-up as a brief LTRO-effect.



Source: IR&M, Bloomberg. Note: Model consists of 22 economic variables and is work in progress.

Germany: declining

The trend is down now. Our own surprise index turned negative on 18.5.12. Note that industrial production figures have not only been negative and below expectations; March figures were also revised downwards. These downward revision generally occur in the direction of the trend, ie, down in this case.

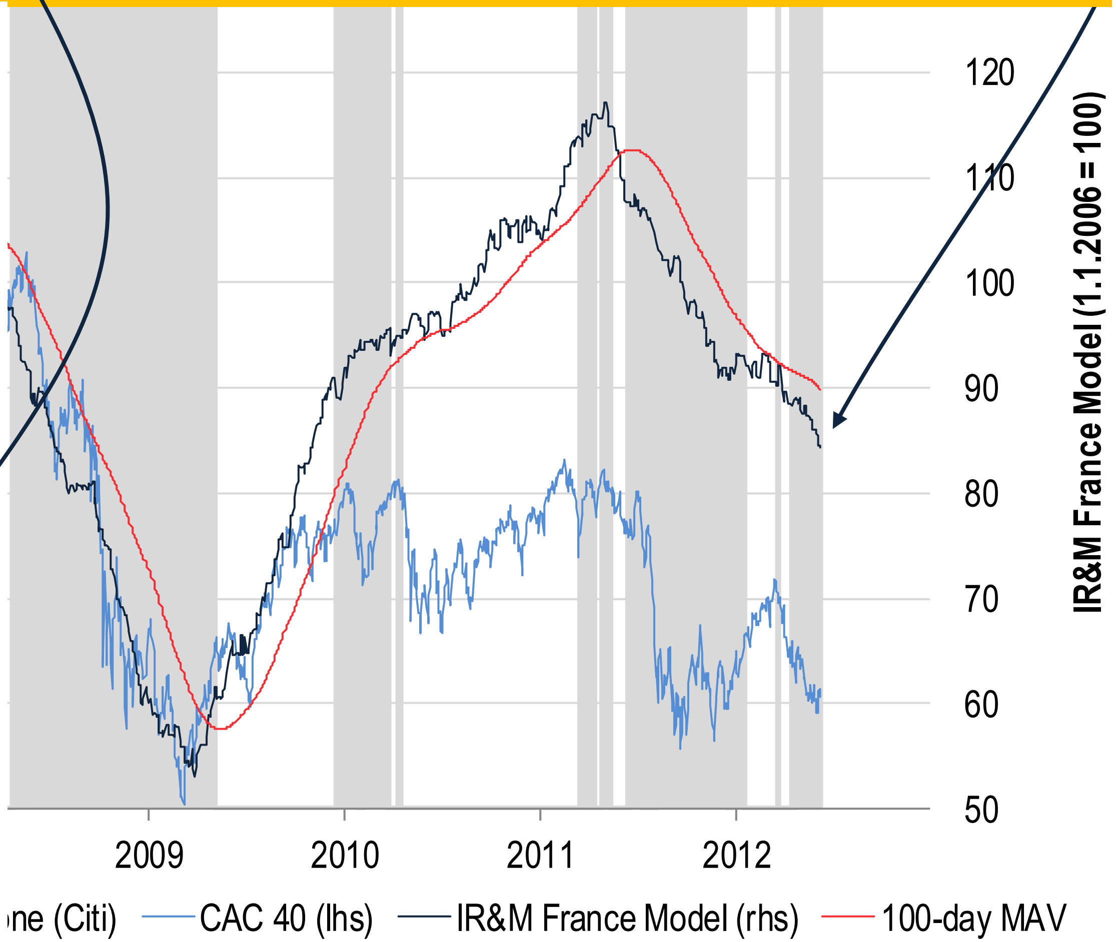


Source: IR&M, Bloomberg. Note: Model consists of 14 economic variables and is work in progress. Surprises index is our own.

France: declining

Still in decline. We came across the idea that Mr. Hollande is politically savvy and not as economically daft as he appears, will find an elegant way to back off from his (economically) idiotic election promises, and eventually do all the right things. Improbable; but a possibility nevertheless.

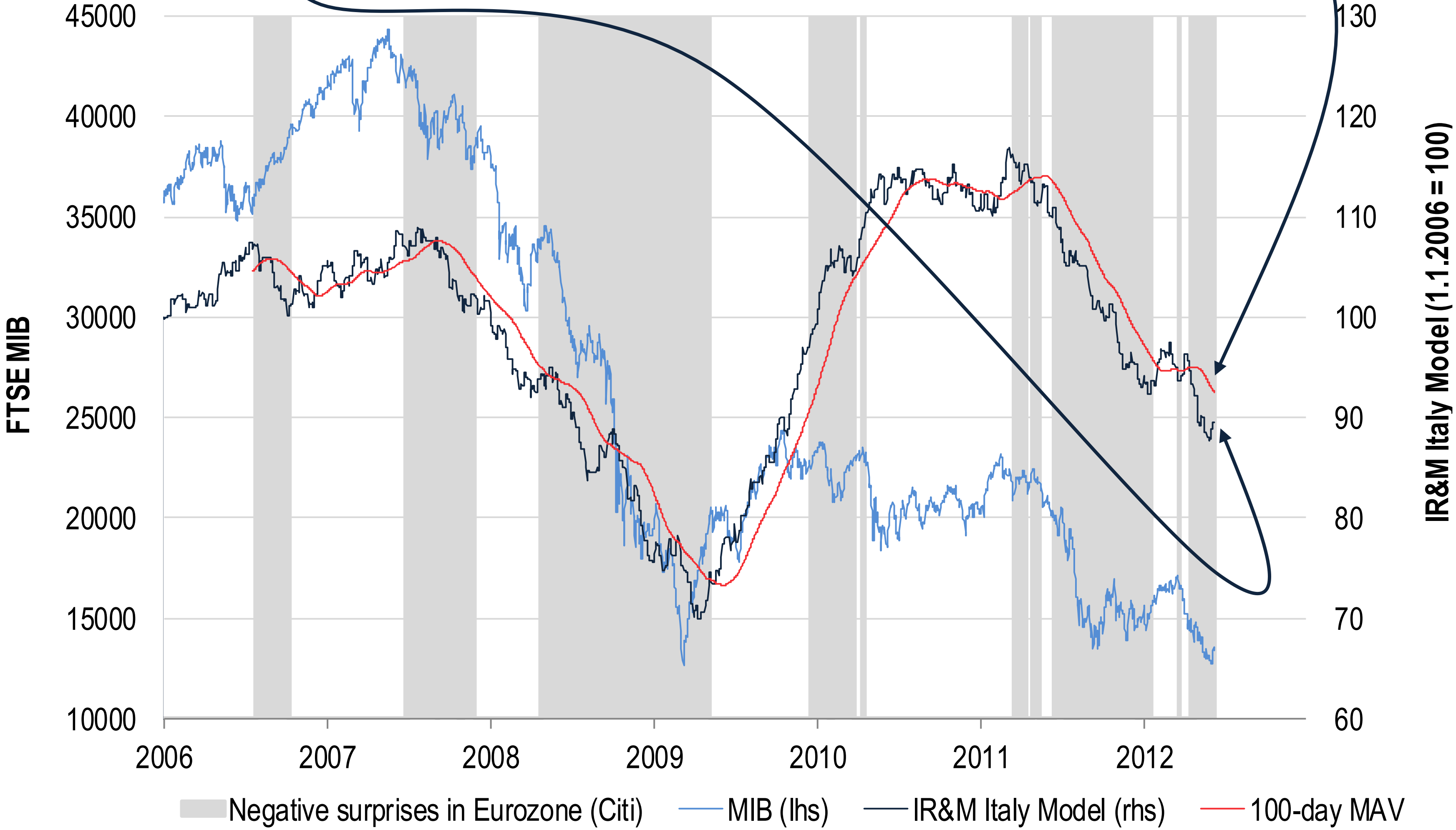
Having lowered the retirement age back to 60 for people who have worked for 41 years, France's new government said it plans to ramp up the cost of laying off workers for companies in coming months after the unemployment rate rose to 10%. "The main idea is to make layoffs so expensive for companies that it's not worth it" according to the Labour Minister. With Spain and Italy doing the opposite, France may end up losing jobs to southern Europe.



Source: IR&M, Bloomberg. Note: Model consists of 15 economic variables and is work in progress. Surprises are shown for the Eurozone.

Italy: declining

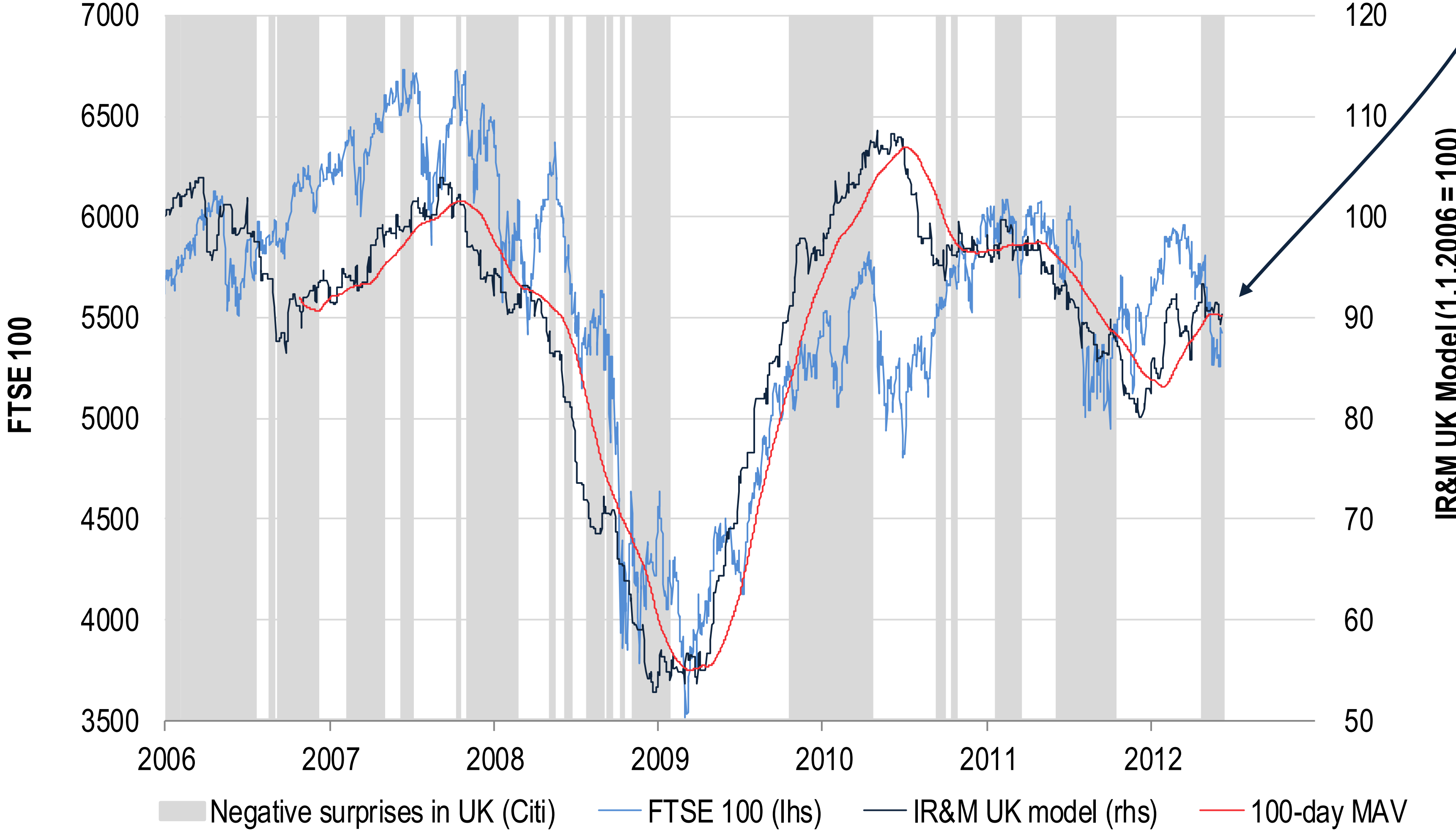
Small uptick and some recent data points surprising slightly positively.



Source: IR&M, Bloomberg

UK: declining

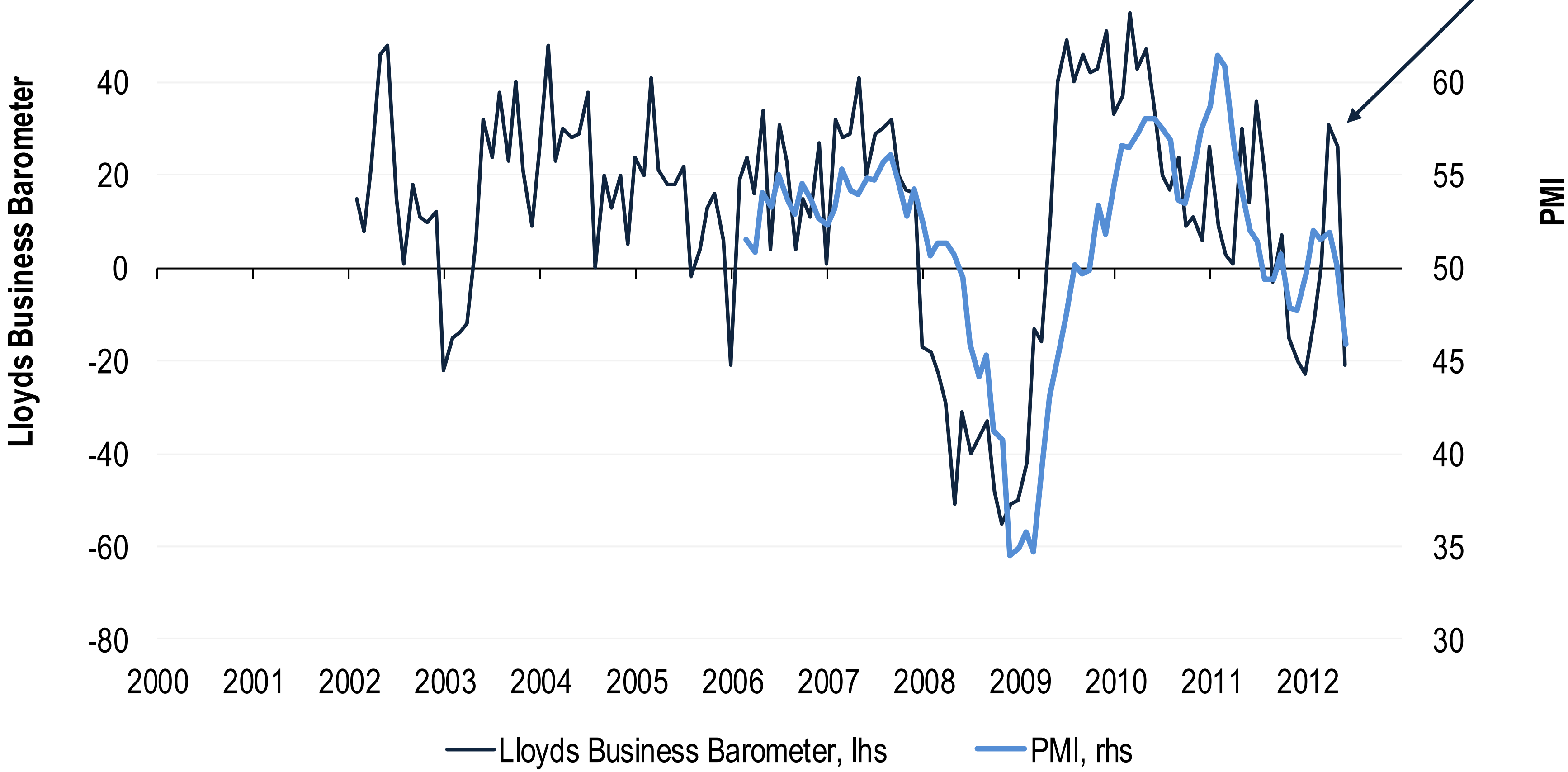
Surprises have been negative since 27.4.



Source: IR&M, Bloomberg. Model consists of 17 indicators and is designed to give a data point nearly every day. The model is work in progress.

UK economy: declining

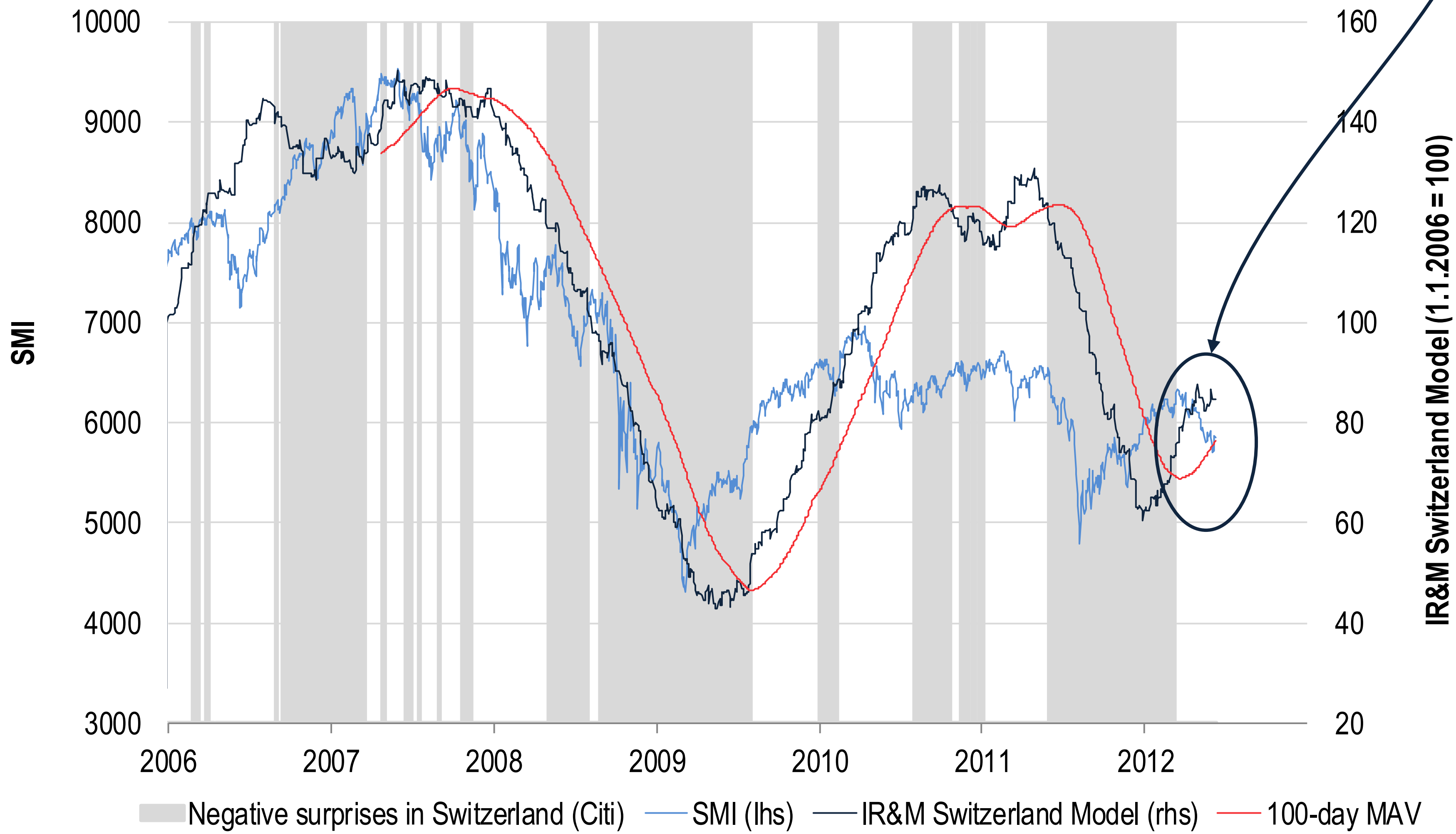
The Lloyds business barometer reported its 3rd largest rise in March. With the benefit of hindsight this seems like an error. (Alternatively, perhaps the people surveyed were really excited ahead of the Queen's Diamond Jubilee.) The direction of the UK economy is now reasonably clear; surveys and PMI being consistent.



Source: IR&M, Bloomberg.

Switzerland: improving

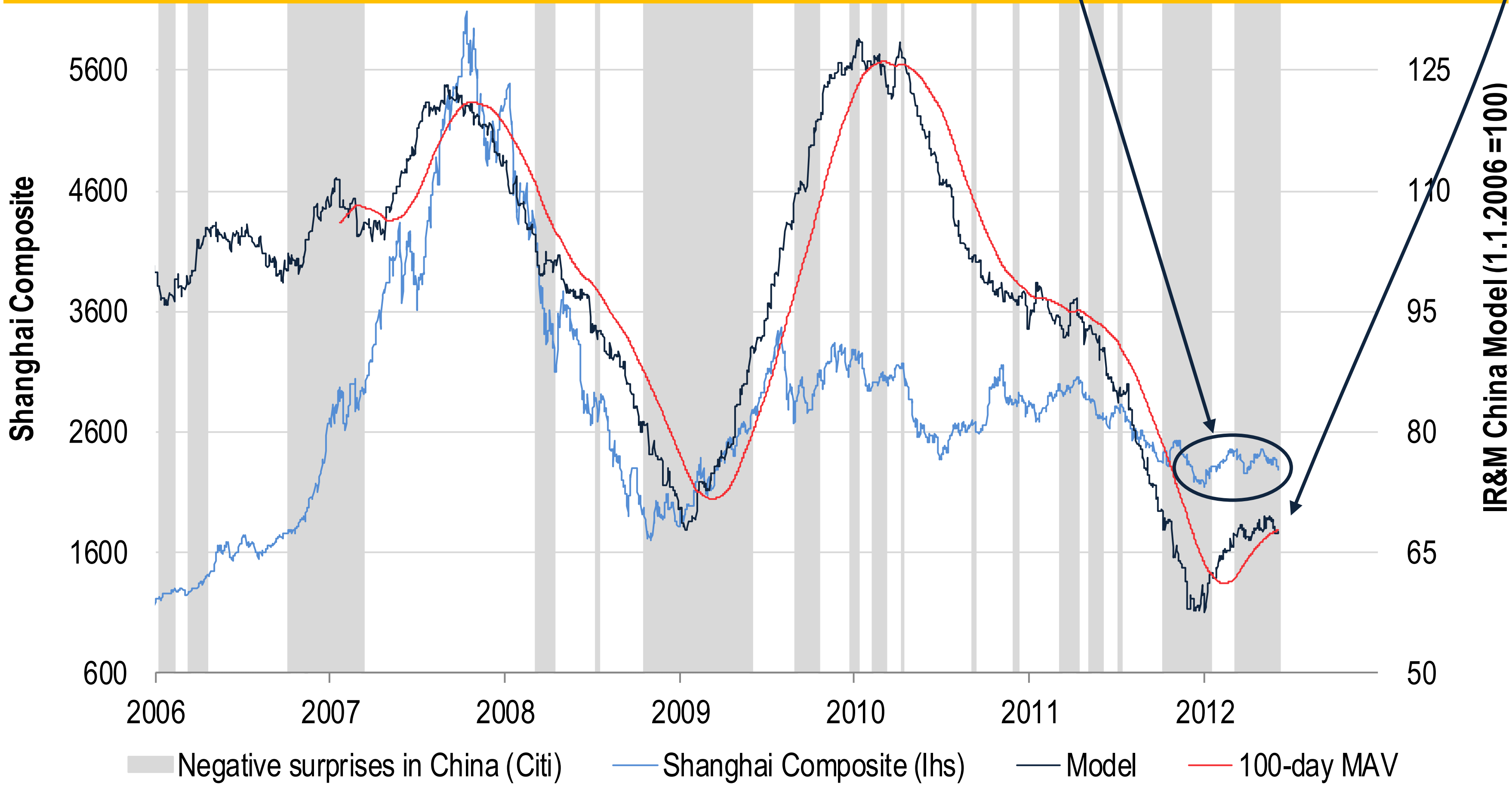
Surprises have been positive since 8.3.12. However, the PMI is now also at around 45, similar to those of the main European economies.



Source: IR&M, Bloomberg. Model consists of 14 economic indicator and is work in progress.

China: at inflection point

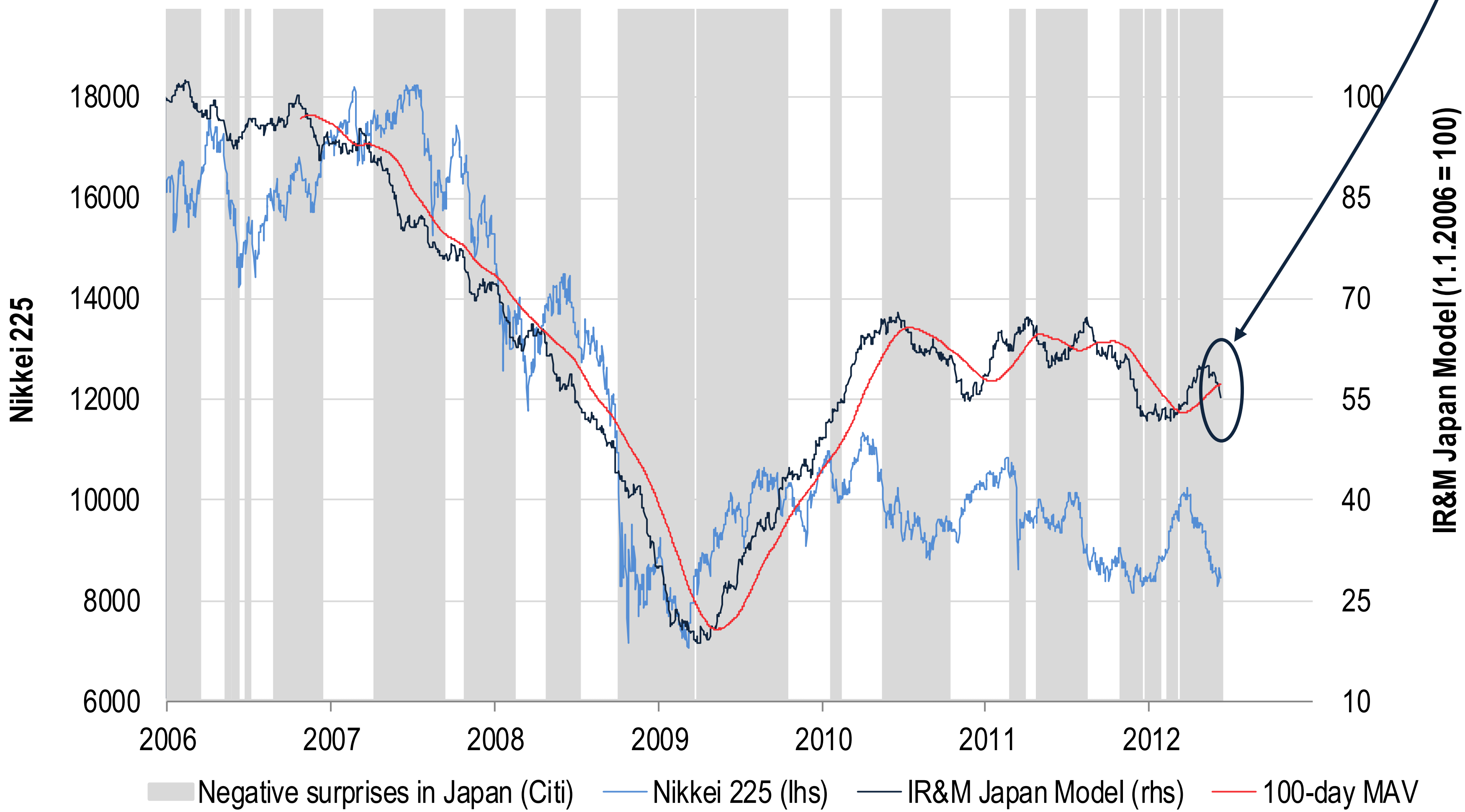
Nothing has changed. The surprise rate cut could be interpreted both ways: bad, otherwise no cut would be necessary; good, the authorities (via central banks) are doing something about it. Surprises have been negative since 12.3.12 but the stock market is not falling, but holding.



Source: IR&M, Bloomberg. Note: Model consists of 22 monthly indicators and a weekly read of change in yield curve. Model is work in progress.

Japan: declining

Most recent data points were negative, causing the MAV to be broken. Note that the surprises have been negative since 31.10.11 with very short-lived interruptions. JPY just too stong.



Source: IR&M, Bloomberg

Hitting the proverbial nail on its head

"The fundamental question is relatively simple. Do our partners really want more Europe, or do they just want more German money."

—German government official, Berlin, 4 June 2012

"Zombies should be in films not holding the deposits of you and I."
—Fintag, blog, 6 June 2012

"The reflexive interplay between imperfect markets and imperfect authorities goes on all the time while bubbles occur only infrequently. This is a rare occasion when the interaction exerts such a large influence that it casts its shadow on the global economy. How could this happen? My answer is that there is a bubble involved, after all, but it is not a financial but a political one. It relates to the political evolution of the European Union and it has led me to the conclusion that the euro crisis threatens to destroy the European Union."
—George Soros, Remarks at the Festival of Economics, Trento, Italy, 2 June 2012

"Christmas is a time when kids tell Santa what they want and adults pay for it. Deficits are when adults tell the government what they want and their kids pay for it."
—Richard Lamm, Big Picture, blog, 6 June 2012

"There are a number of significant downside risks to the economic outlook, and hence it may well be appropriate to insure against adverse shocks that could push the economy into territory where self-reinforcing downward spiral of economic weakness would be difficult to arrest… I am convinced that scope remains for the Fed to provide further accommodation either through its forward guidance or through additional balance sheet actions".
—Janet Yellen, Vice Chair of the Board of Governors of the Fed, Reuters, 6 June 2012

A point well made

This is the reason why we don't ignore softer factors, are not always scientific and quantitative, and are never dogmatic. "Risk" is arguably getting more complex by the day.

Our new age of volatility defies spreadsheet strategists

Gillian Tett

Why are investors engaged in a "dash for cash" (or a flight into any havens that they can find)? It is not hard to think of reasons: doubts are rising about the future of the eurozone, the underlying developed world economic data are grim – and in the US there is concern about the prospect of a "fiscal cliff", or new debt debacle.

But in addition to these obvious concerns there is another, more subtle factor at work. As turmoil builds, investors and policy makers are being tipped into cognitive shock. In the past few decades, most investors have operated as if the world was a place in which the key variables could be plugged into a spreadsheet or computer model. Ever since the computing revolution took hold on Wall Street and the City of London in the 1970s, finance has been treated not as an art but a science – and banks have operated as if computer models could not just explain the past but predict the future, too.

Now those "quants" and rocket scientists find themselves at sea. Computer models alone can no longer calculate meaningful probabilities about what will happen next in the eurozone. Instead, what really matters now in places ranging from Finland to Greece are non-quantitative issues such as political values, social cohesion and civic identity. Above all, the question of "credit" is key to working out whether bonds can ever be repaid. But this is not credit in the mathematical sense by which banks have often defined it (as a projected probability on a chart), but in the old fashioned, Latin – social – meaning (trust). The crucial variable, in other words, is whether voters have faith in their governments and central banks. Do they trust the safety of their banks? Are citizens willing to trust each other, and co-operate, when pain is imposed?

To be sure, these non-quantitative issues would be familiar territory to any banker who practised the craft in the middle of the last century. Seven long decades ago, when trainees joined institutions such as JPMorgan and Citibank, for example, they were taught that they could not assess credit risk from quantitative factors, such as cash flow, alone. Questions of "character" mattered, too, be that of companies, individuals or countries. When investors analysed risk in emerging markets such as Argentina, Turkey or Indonesia, they paid close attention to political risk, civic values and social culture

But in supposedly "developed" countries, such as the US and Europe, these "soft" issues have often been ignored. Instead investors have focused, almost exclusively, on numbers such as inflation and debt. Severe political risk was seen as an emerging markets problem; it applied to banana republics, but not the western world.

> **The new mental landscape is terrifying for investors who have spent their careers relying on computer models**

As a result, the turmoil in the eurozone leaves many investors dazed and confused. Never mind the fact that the fiscal "numbers" of many emerging market countries now surpass those of western nations, or that some emerging market nations are now considered less risky than developed ones. (Mexico, to cite just one example, has more credibility in the credit derivatives market than Spain.) The really big shock is that soft, social issues are suddenly becoming crucial to the developed world. Most notably, with voters in Europe having kicked out almost a dozen incumbent governments, and political extremism on the rise, questions of social cohesion and trust matter deeply. This type of risk cannot be factored into a spreadsheet.

The good news is that many institutions are scrambling to embrace this mental shift. Most large investment banks on Wall Street and in the City have expanded their political and social expertise this year. Rating agencies such as Standard & Poor's have been subtly changing their internal ratings processes to emphasise soft factors, such as political culture. Large asset managers are telling their clients that it is foolish to rely on models alone, and some government institutions are adapting, too. Senior officials at the European Central Bank have started memorising briefing packs about eurozone social and political trends, alongside their usual monetary numbers. "It's quite a change," one senior ECB official told American investors last month. "I spent most of my career studying economics. Now I study political parties, too."

But the bad news is that the new mental landscape is terrifying for many investors (or policy makers), particularly those who have spent their careers relying on computer models. What makes this landscape doubly unnerving is the sheer complexity of all its moving parts. Or, as one of America's biggest asset managers explains: "We like to deal with probabilities, but there are just too many possible outcomes to the eurozone to work them out."

Little wonder, then, that so many investors have been sitting, frozen, on the sidelines, refusing to invest their money or simply dashing for havens. The problem is not simply that the outlook for the eurozone looks dark, but that these shades of black defy any system for modelling risk. There is little chance of this changing soon. We have entered a new "age of volatility", and not just in finance and economics, but in politics and society, too.

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Source: Financial Times 5 June 2012

Target rates: low and falling

China, PBoC suprised by lowering 1Y rates for lending and deposits by 25bp

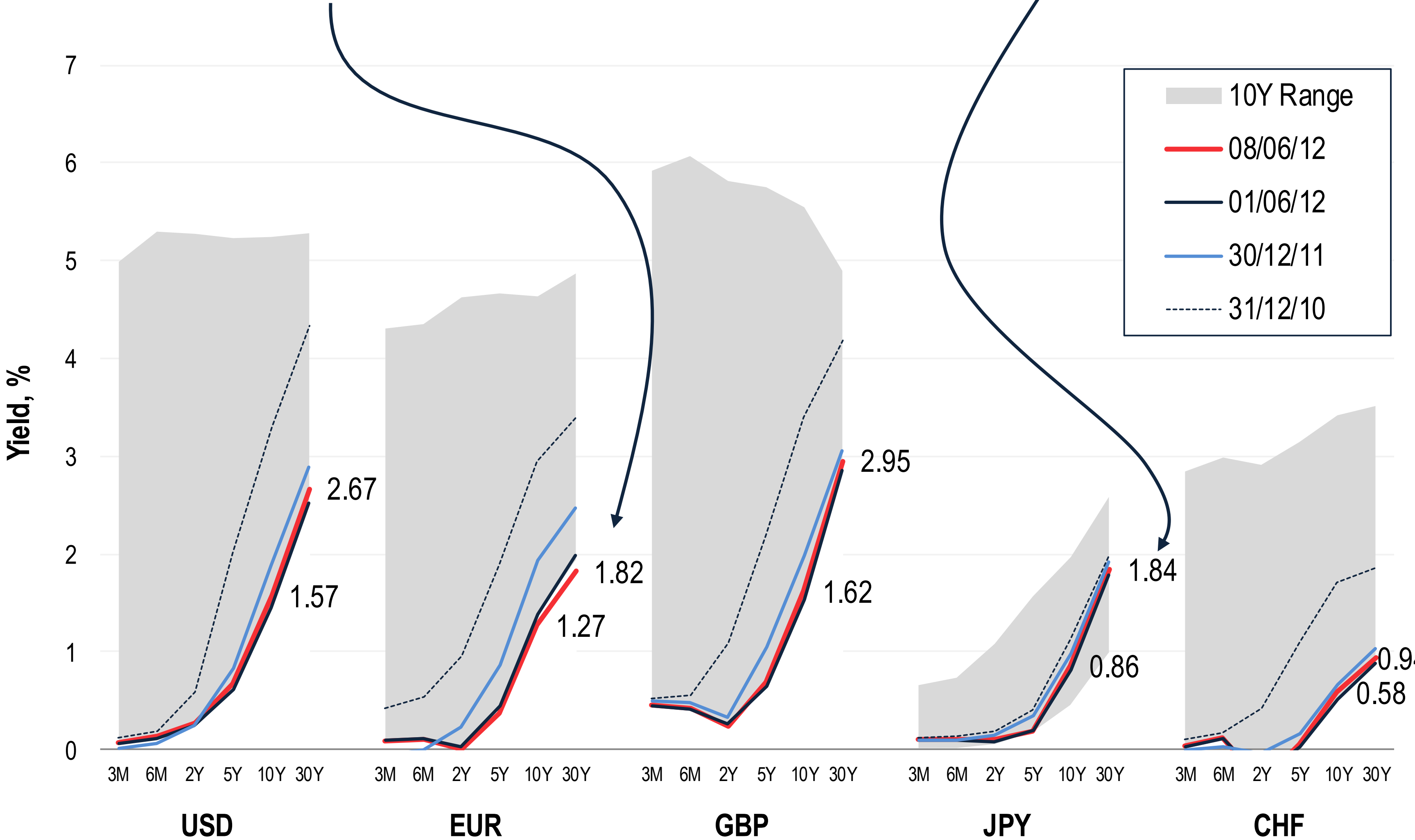
	10-years			2010	2011																	
	High	Low	Median	12 10	01 11	02 11	03 11	04 11	05 11	06 11	07 11	08 11	09 11	10 11	11 11	12 11	01 12	02 12	03 12	04 12	05 12	Last
Average ex Brazil	5.14	0.87	2.25	1.33	1.33	1.36	1.36	1.42	1.42	1.42	1.48	1.45	1.45	1.45	1.39	1.33	1.33	1.33	1.33	1.33	1.26	1.20
United States	5.25	0.25	1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Eurozone	4.25	1.00	2.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.50	1.50	1.50	1.50	1.25	1.00	1.00	1.00	1.00	1.00	1.00	1.00
China	4.14	1.98	2.25	2.75	2.75	3.00	3.00	3.25	3.25	3.25	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.25
Japan	0.50	0.00	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
United Kingdom	5.75	0.50	4.00	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Canada	4.50	0.25	2.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Australia	14.00	3.00	5.25	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.50	4.25	4.25	4.25	4.25	4.25	3.75	3.50
Brazil	26.32	8.39	12.93	10.67	11.17	11.17	11.67	11.92	11.92	12.17	12.42	12.41	11.90	11.40	11.40	10.91	10.40	10.40	9.65	8.90	8.39	8.39
Switzerland	2.75	0.00	0.63	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Easing by 0.25%, while many had expected -0.5%.

Source: IR&M, Bloomberg.

Yield curves: Japanisation continues

EUR 30-year now lower than JPY 30-year.



Source: IR&M, Bloomberg. Note: Figure in graph shows ten and thirty year yields. The high and low of the yield curves are measured by the sum of the six yields of the term structure.

Financial risk monitor

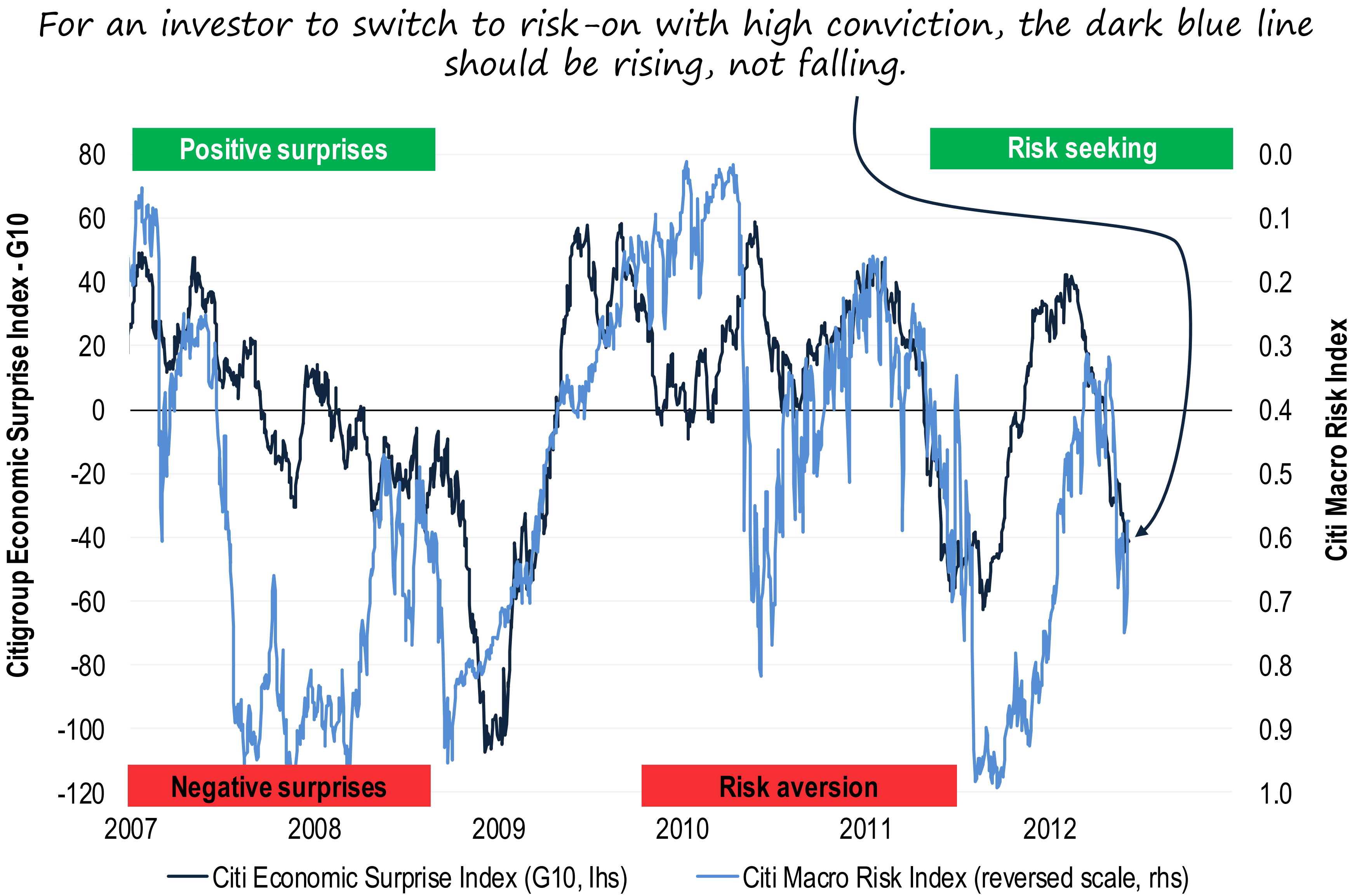
Off it's all time high.

Bernanke speech caused big collective sigh of relief on Thursday. These "big collective sighs of relief" typically wear off after a day or two or three.

Market	Risk proxy	10-year*			2010			2011												2012					
		High	Low	Median	10	11	12	01	02	03	04	05	06	07	08	09	10	11	12	01	02	03	04	05	Last
Composite	St. Louis Fed Stress	5.5	-1.3	0.2	0.2	0.2	0.1	0.0	-0.1	-0.1	-0.2	-0.1	0.1	0.0	0.8	1.1	0.7	1.0	0.7	0.5	0.3	0.1	0.2	0.4	0.5
	BB Financial Conditions	1.3	-12.7	-0.1	-0.1	-0.3	0.2	0.1	0.4	0.4	0.6	0.5	0.5	0.0	-0.9	-1.8	-1.0	-1.0	-1.0	-0.5	-0.1	0.1	0.0	-0.7	-0.6
	Citi Macro Risk	0.99	0.0	0.42	0.36	0.51	0.28	0.33	0.32	0.32	0.31	0.44	0.40	0.68	0.90	0.97	0.82	0.85	0.79	0.59	0.47	0.36	0.35	0.72	0.58
Liquidity	LIBOR 1M OIS Spread	338	1	9	7	7	8	9	11	12	10	9	8	8	13	15	16	18	22	17	13	12	10	8	8
	Euro Libor-OIS Spread	196	-2	26	22	33	41	21	25	21	16	28	20	35	64	81	81	98	97	77	63	42	39	39	40
	Euro Basis Swap Spread	-3	-300	-36	-26	-56	-60	-31	-33	-21	-8	-26	-28	-46	-80	-105	-92	-131	-114	-72	-67	-51	-45	-50	-53
Credit	TED Spread	464	9	30	18	15	18	16	17	21	24	21	24	16	32	35	44	53	57	49	41	40	37	40	39
	EmMa Spread	1037	111	278	255	277	241	246	237	227	234	247	239	256	336	462	376	418	425	398	338	314	330	413	401
	CDX.NA.IG	279	29	94	94	100	85	84	82	96	88	89	91	96	115	144	121	128	120	101	94	91	95	123	122
	iTraxx 5Y Europe	217	20	87	97	117	105	98	98	102	97	102	106	117	153	202	162	185	173	143	129	125	140	180	174
	iTraxx 5Y E. Crossover	1150	150	406	458	522	437	416	386	384	353	370	395	438	646	839	660	757	755	620	568	613	650	719	699
Sovereign	iTraxx 5Y E. Sovereign	386	47	180	152	203	210	176	179	174	187	197	217	270	293	339	304	327	357	338	343	269	275	326	318
(5Y CDS)	Greece	5047	5	32	805	976	1074	869	941	1003	1350	1420	1952	1722	2261	3536	>5000	essentially default							
	Ireland	1192	5	217	472	611	615	596	585	642	661	669	769	790	769	700	694	711	726	621	603	572	566	726	682
	Portugal	1527	4	23	378	543	500	433	465	580	653	679	745	924	918	1110	970	1060	1093	1484	1175	1076	961	1185	1112
	Spain	604	3	34	215	365	350	249	249	233	237	251	270	363	358	382	340	408	394	376	368	437	476	599	572
	Italy	592	6	24	171	269	238	180	183	151	148	164	171	310	361	470	445	487	503	416	381	397	445	563	528
	Belgium	406	2	8	117	201	218	173	174	139	143	151	143	199	230	260	269	304	316	245	238	233	252	282	271
	France	250	2	10	70	105	101	99	91	74	74	73	80	122	154	187	176	200	222	181	176	169	193	219	209
Rates	BBOX (swaption volat.)	138	68	92	88	96	101	100	97	99	96	96	98	98	93	94	96	97	94	86	91	89	86	82	82
Bonds	MOVE (bond volat.)	265	51	97	100	102	110	96	91	91	77	72	89	88	98	101	107	100	91	72	76	79	63	74	82
Equities	VIX (equity volat.)	81	10	19	21	24	18	20	18	18	15	15	17	25	32	43	30	28	23	19	18	16	17	24	22
	Skew Index (CBOE)	142	106	118	116	117	121	130	129	125	127	124	122	121	120	115	121	117	116	122	125	125	120	119	120
FX	VXY (G7 FX volat.)	24	6	10	13	13	13	11	10	11	11	11	11	12	12	14	12	13	12	11	10	10	9	11	11

Source: IR&M, Bloomberg. *Note: 10-year history where available.

Economic surprises vs macro risk



Source: IR&M, Bloomberg

Central bank assets: contracting

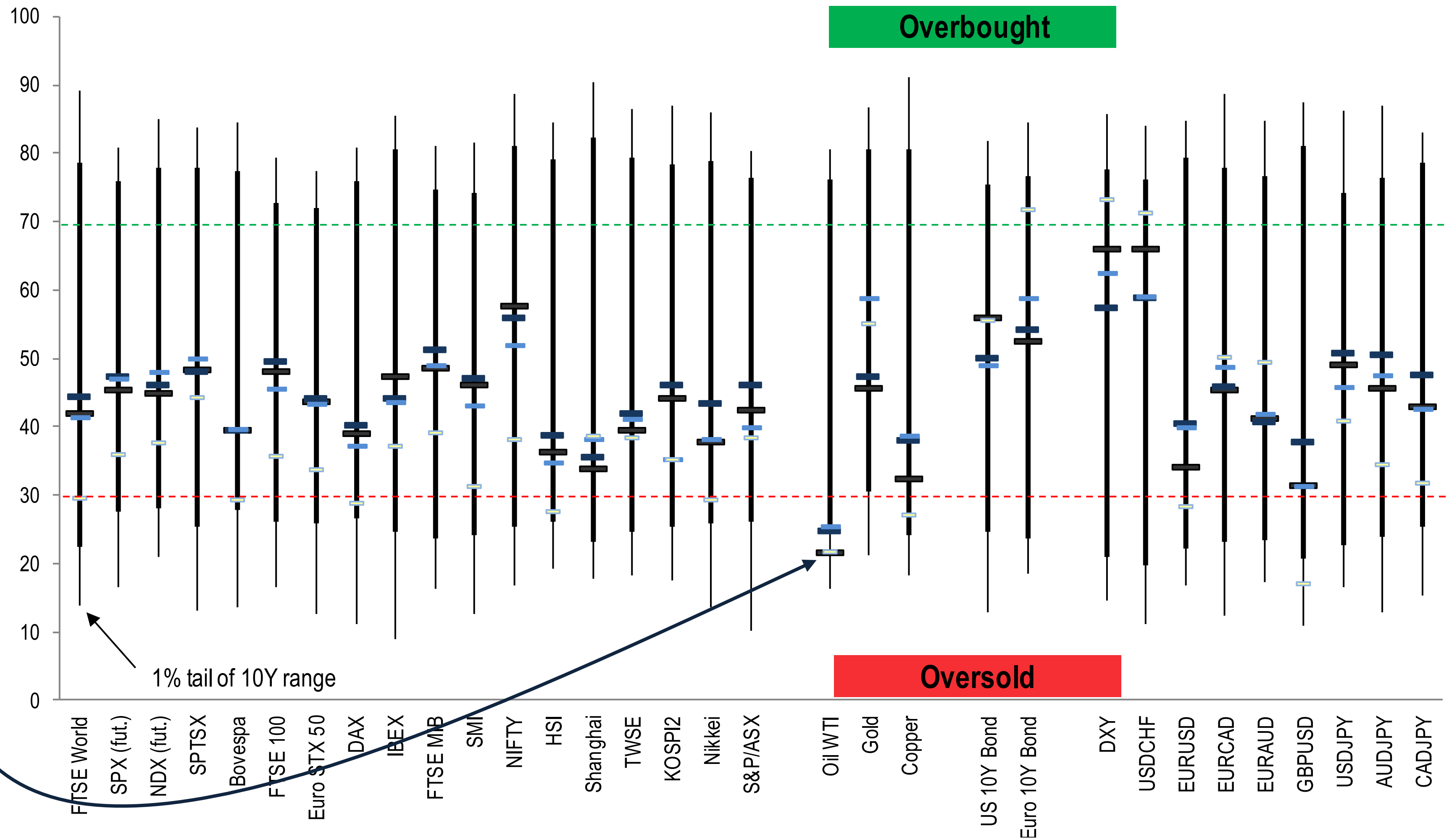
The longer term trend is up of course.

Balance sheets have contracted from $8.70tr on 5.3.12 to $8.34tr on 8.6.12.

Source: IR&M, Bloomberg.

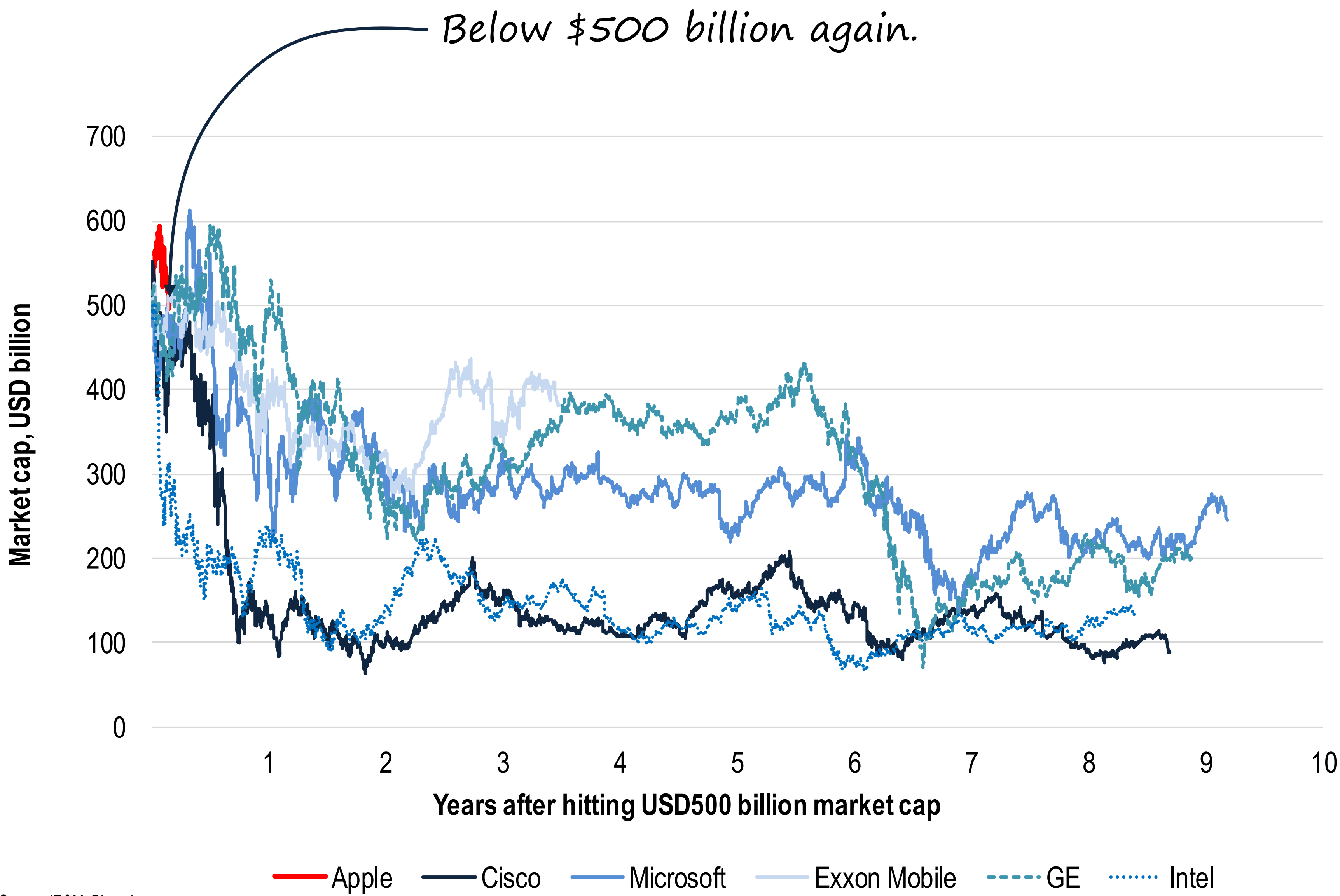
Short-term: Relative Strength Index

Oil was massively oversold; bounced a bit, and is again massively oversold,



Source: IR&M, Bloomberg. Notes: The observation period is the last ten years. The largest tick shows most recent RSI: second largest tick shows RSI the day before, etc. Update was done 8.6.12. 4pm CET.

Graph of the week – for what it's worth…



Source: IR&M, Bloomberg
As of 7th June 2012

Selected publications*

Waiting for the next fix	1 June 2012	Global economy stabilises a bit	22 December 2011
Hopium running low	25 May 2012	Santa put	8 December 2011
Euro area tearing itself apart	18 May 2012	Europe in the tails	28 November 2011
PMIs make for horrid reading	7 May 2012	Gap between US and Europe opening	16 November 2011
Just in the middle of the river	2 May 2012	October looks like a short sigh of relief	3 November 2011
Risky fragility	19 April 2012	On can kicking and bouncing dead cats	25 October 2011
What makes bears blush (Q2 2012 report)	**11 April 2012**	Kicked can cause dead cat to bounce	16 October 2011
Conditionally well but subject to revision	4 April 2012	Beware of lights at the end of tunnel	7 October 2011
Not yet out of the woods	22 March 2012	**Europe doubling down (Q4 2011, inaugural report)**	**3 October 2011**
Eerily unchanged	15 March 2012	Europe is levering up, ie, doubling down	30 September 2011
Ltroveneous double liquidity whammy	2 March 2012	Summer of 2008 revisited	23 September 2011
Bullish middle-game: an intermezzo?	17 February 2012	Depression rather than recession	16 September 2011
Shooting the economic lights out	3 February 2012	Déjà vu	9 September 2011
Confidence rally	27 January 2012	Global economy arguably in recession	2 September 2011
Relatively difficult (Q1 2012 report)	**16 January 2012**	Risk levels in Europe have risen strongly	26 August 2011
		US recession a sure thing	19 August 2011
		PIIGSF?	12 August 2011
		Early indications continue to deteriorate	5 August 2011

Source: IR&M

* IR&M's risk management research is subscription based. Research related to "absolute returns" in general is freely available under www.ineichen-rm.com

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