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Polar Futures Guarded Opportunity

February 2018

Monthly Performance = 1.11%
YTD = 5.65%
**net of fees*

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Well if we had forgotten what volatility looked like, we got a very quick reminder at the start of February. The 4 trading days circled (left), gave back the previous 4 months of gains in the S&P. It had been over 15 months since the CBOE VIX index had hit 20 or higher, and it was very likely this complacency (or the product structured around it) that exacerbated the moves. While being aware the huge run in stocks through January was unlikely to persist, we still got caught by some sharp moves in the month. Even with that, we were able to rely on our risk management principles to come through the month with a positive 1.1% return. Given the circumstances returns could have been better, but the possibility for returns to have been worse, or much worse, was even bigger.

We had been short of the US 10yr Treasury notes since November as it was my view that rates would be heading higher into the start of 2018 and would likely test the 3% level, if not even higher. This trade idea had been working well and was our top performer through January. We got two trading days of further gains in February, however the US employment report on Feb. 2nd upset markets. The wage gains especially stoked fears of inflation that initially moved rates higher, however the report also sparked a sell off in equites. The following Monday stocks sold off hard and bonds finally started to catch a bid *(large price action circled on the chart).* While I wanted to give this trade some room, having stops in the market was a must. When stocks were sliding further on Monday evening, the 10yr notes jumped high enough to stop us out of the trade at a loss for the month. While getting hit on a stop is never ideal, I have no regrets about having the stop orders working. There was no way of knowing how low stocks (or how high bonds) could have gone during that selloff. Managing the risk was far more important than hoping for the reversal that ended up happening the next day.

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We had a gold trade that went hard against us in January as the USD had a sharp drop during the month. What little premium was left in this trade did pick up some value as gold moved lower through the start of the month, even as stocks were tanking, but went to zero as gold saw a sharp mid-month rally. Gold is managing to hold its move away from the influences of real rates, but still looks vulnerable to any pick up in USD strength.

The Canadian dollar trade established at the end of January started against us with the highest daily closing level in over 4 months on the first day. However, after the strong US employment report CAD was turned lower and never looked back. While it was the USD strength that finally prompted the turn in CAD, this trade was more about a weak CAD story than a strong USD. As I highlighted in last

month’s letter, while the strength of the USD is key to success in trading CAD, I thought there was “laundry list” of issues facing the currency. These issues proved too troublesome as CAD underperformed against almost all other currencies (not just USD). CAD was facing continuing trade issues, real-estate softening into the start of 2018, oil spreads staying wide and interest rate differentials moved further in the favour of the US as diverging central bank policy seems to be coming back into focus. I had an original target of 77.50 cents for CAD, but given that this month saw a move from 81.50 to 78.00 while the USD was only marginally stronger, I think CAD could have much further to go. I will be cautious as we approach the 77.50 support of last fall, however if possible I will try and stick with this trade as the dynamics look to be getting much worse for CAD. It will always be my goal to enter trades with limited risk, while trying to give them every opportunity to provide the greatest upside potential. This was our best performing trade of the month.

We also saw increased volatility in the oil market through the month as prices moved lower from the recent 3 year highs of $66. I had been looking for an opportunity on the short side of crude as US production has come back in huge fashion while speculators seem perfectly willing to believe that OPEC will keep prices moving higher as they have amassed record size long positions. Oil turned lower on the USD strength at the start of the month and dropped further with stocks. We used the small bounce in the break lower to establish a position looking for the move to start pushing out some of the long speculative positions. We saw a sharp move in the first few days to support above $58. I thought that looked to be temporary as we worked toward my initial target of $55. However a sharp mid-month rally seemed to feed on the “risk on” attitude from a rebounding stock market even as US production continued to grow. After we got through $62 I re-structured this trade to reduce the near term risk in the trade as I continue to believe that we will still need to see significant re-positioning in this market that will come with sharply lower prices. In hindsight, taking the gains from the initial move lower and then “reloading” on a bounce would have proven more profitable, however I stilled haven’t figured out how to put a “last week” order in at the CME. Along with the dynamics in the oil market, I’m looking for some USD strength to put some additional downward pressure on oil going forward.

Until next month,

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