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Polar Futures Guarded Opportunity

May 2018

Monthly Performance = 0.13%
YTD = 0.75%
**net of fees*

We were a hair above flat after fees by the end of May. The month was marked by another bout of volatility, although this time it originated in the bond markets and was centered around Italian bonds. The Italian 2yr bond yields jumped over 300bps in a matter of days when the country didn't have clear leaders in government and the possibility of anti-EUR sentiment in the country was growing. This sharp rise in Italian yields saw capital around the world return to "safe haven" destinations.

We had been short of the US 10yr Note since the beginning of April thinking that rates would break up strongly through the 3% over the next few months. The economic background in the US is continuing to look firm and with inflation moving higher I believe the Fed will be on a path to hike rates at every second meeting, a sentiment that still isn't priced into markets. After the initiation of the position we saw a good move lower in notes (opposite of yields) through the end of April before they had a small bounce at the beginning of May. However by later in the month notes were making new multi-year lows as yields broke above the important 3.05% resistance level and hit a high of 3.11%. At this point I thought we could see a sharp move higher in rates that would greatly benefit our position. Wanting to be able to stay with the trade for that sharp move higher I gave it plenty of room for fear of getting stopped out as we did earlier this year on the 10yr. However the severe move in Italian bonds at the end of the month caused a rush for safety into US treasuries. This dropped US 10yr yields over 30bps in seven trading days and was enough to knock us out of the position. I still think a sharp move higher in US yields is the most likely scenario; however the ongoing geopolitical/trade risk will make position timing very important for the risk/reward setup.

We continued to hold a short position in Oil that was established in April. Oil looked to be capped under the $70 level through April but broke sharply higher through mid-May on continued production drops in Venezuela and fears about Iranian production coming offline with Trump pulling the US out of the nuclear agreement. This position had lost most of its value at these market tops, but towards the end of the month we saw rapid price drops as the Saudi and Russian oil ministers talked about the allowing more OPEC production to ease the reduction from Venezuela and Iran. I think this put a "price cap" in place, as the swing producers will step in at this upper price range to realign the supply/demand picture. This cap will greatly change

the risk/reward parameters for the huge number of speculative long positions in the market and I think it is likely we could see a wave of these positions sell causing further price depreciation. I am looking for this sharp break lower in oil, but I will look to get out of the position quickly if prices start to head back higher.

We had restructured our EUR trade at the beginning of last month to allow more time for what I think could be a continual selloff. The EUR economic picture continues to slow from the start of the year, showing that it wasn't just first quarter softness. I continue to believe that given the stronger data in the US the Fed will be on a more hawkish rate hiking path than the market is currently pricing in. Even though we may see the ECB start to talk about a less accommodative policy going forward, I still think we will continue to see interest rate differentials widen against the EUR. If we do see European bond yields rise due to ECB policy, it is likely that the Italian bond yield situation that flared up at month end could come back. This in turn would drive German yields lower again as capital finds safety within the continent. Given the sharp move the EUR had through the end of April and beginning of May, I took measures to lock in some of the profit on the trade as the currency had dropped over 5 cents in less a month. Unfortunately the EUR traded much lower through to the end of the month that we didn't capture. We remain in a spread position at month end that we can work against to establish timely short bias trades against the EUR as I still believe there is lower to go.

The trading through this year has seemed to be three steps forward and then two steps back, which has been a little frustrating. I have been happy with the process of identifying good opportunities and entry positions on trades. However we have seen several trades with good open gains, back up to become only marginal winners once they are closed because I am looking for larger moves over the medium term. Conversely, taking a more cautious approach on the EUR this month caused us to forgo a large portion of the move later in the month. As such, moving forward I will try to be a little more tactical in taking the winning positions sooner on any backup in price, but will also try and get back into a trade that has a longer term thesis driving it. The goal going forward will be that in a more tactical approach we can take three steps forward and only one step back as we work to lock in more gains going forward.

Until next month, Drew Zimmerman

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