

Weekly Market Summary

September 18th, 2020

Done with the Nasdaq Whale ... Time for the Oil Whale??

Fadi Nasser - Deputy Chief Investment & Treasury Officer

Latest Update on Coronavirus: Confirmed cases last at 30.38 million, with the death toll from the pandemic at 951,184. France's daily coronavirus cases have risen by more than 10,000 to the highest since the end of lockdown in May and Health Minister Olivier Veran warned that the disease "is again very active" in the country. Joe Biden (alias "Sleepy Joe"! 😊) has gone after President Donald Trump again and again over his handling of Covid-19, calling Trump's downplaying of the pandemic "criminal" and his administration "totally irresponsible". Dr. Anthony Fauci, the leading US infectious disease expert has pledged to "take the heat" for any potential problems with a vaccine for Covid-19 in his latest interviews with MSNBC whilst singer Dua Lipa has teamed up with James Corden to give fans dating advice amid the novel coronavirus pandemic.

Big players that are capable of moving markets with large trades are known as "Whales". The term is borrowed from casino gamblers and refers to individuals/entities with a substantial amount of capital. Market Whales are spotted periodically in cryptocurrency, credit, fixed-income and foreign exchange markets (remember Britain's Black Wednesday – on September 16th, 1992 - when George Soros broke the Bank of England by betting against the British pound and pocketing \$1.0 billion in profits?)

In January 2012, Jamie Dimon commented on the Volcker Rule (part of the Dodd-Frank Wall Street Reform and Consumer Protection Act – originally proposed by American economist and former US Federal Reserve Chairman Paul Volcker), saying that "*part of the Volcker Rule I agreed with, which is no prop trading. But market making is an essential function. And the public should recognize that we have the widest, the deepest, the most transparent capital markets in the world. And part of that is because we have enormous market making.*" Few months later (precisely April & May 2012), large trading losses occurred at JPMorgan's Chief Investment Office, based on transactions booked through its London branch. A series of derivative transactions involving Credit Default Swaps (CDS) were entered, reportedly as part of the bank's "hedging" strategy. Trader Bruno Iksil, nicknamed the London Whale, accumulated outsized CDS (Credit default Swaps contracts) positions in the market; An estimated trading loss of US\$2.0 billion was initially announced, with the final damage reaching in excess of US\$6.0 billion by the end of the second quarter! On the company's emergency conference call, JP Morgan Chase Chairman, CEO and President Jamie Dimon said the strategy was "*flawed, complex, poorly reviewed, poorly executed, and poorly monitored*". These events gave rise to a number of investigations to examine the firm's risk management systems and internal controls, and a US Senate report published in March 2013 - after 9 months of investigation - found that Dimon personally misled investors and regulators the previous year, as losses were dangerously mounting on this "monstrous" derivatives bet. According to Carl Levin, Chairman of this panel, JP Morgan had "*a trading operation that piled on risk, ignored limits on risk taking, hid losses, dodged oversight and misinformed the public*".

Fast Forward to September 2020

As we reported last week, Masayoshi Son's conglomerate – SoftBank Group Corp., was behind the spectacular ride in large-cap US technology stocks in recent weeks that lifted the broader market and, in effect, made investors nearly forget the Covid-19 crisis for a moment. The "Nasdaq Whale", as the FT called the Group, appears to have made a monstrous options trade that effectively amounted to spending billions of dollars on purchasing out-of-the-money call options tied to

around \$50 billion worth of individual tech stocks (forcing those on the other side of the trade to buy more options or simply buy the underlying stock to hedge their short positions). That left investors and market observers struggling to explain exactly why their share prices took an extra leg up over the summer and made them ponder whether to stick with a responsibly diversified portfolio that would be destined to underperform, or chase the frenzy. It also led to a sharp sell-off in SoftBank Corp. shares at the time the news was revealed on September 9th (shares have recovered since). In past week, stocks have wildly fluctuated on an intraday basis - with weak market openings attracting buy-the-dip investors only to have the resulting bounce in stock prices bring out sellers by the close - though they have remained confined to very narrow ranges on a close basis (week-on-week move of less than 0.50%). This afternoon, traders could face some market turmoil with the expiry of options and futures on indexes and equities, a quarterly event known as quadruple witching that typically fuels added trading as large derivatives positions roll over around the open of markets.

Who Let the “Oil Whale” Out?

In early September, as the summer driving season was fading in the rear-view mirror, oil markets began taking a distinctly chilly air. At the same time, analysts started suggesting that the recovery in demand was officially stalling. With spare capacity widespread throughout the supply chain and huge stockpiles of crude and refined products still in place adding to fears of a second wave coronavirus spread, the risk-reward was clearly for a retracement lower in prices following the strong rebound from the depths of the pandemic-induced slump. Add to that OPEC+ group of 23 countries' decision to raise their combined output target by 2 million barrels a day from the start of August and a stalling consumption recovery in Asia (especially India) - and clearly all signals were in place for a bleak short-term outlook for the “black gold”. Between September 4th and September 8th, WTI oil prices took a major dive, falling roughly 14% (from a high of \$42 to a low of \$36 per barrel; Brent prices also followed suit, dropping from \$44.50 to \$39.25). That prompted bank of America Merrill Lynch to predict that it would take three years for global oil demand to recover from Covid-19 assuming there is a vaccine or a cure in between. And whilst nobody assumed a return to the dark days of April, when US crude briefly traded in negative territory, the tone of the market was nonetheless turning more bearish; Traders were now starting to position for more bad news on the way (Corona cases surging in Europe, Chinese oil imports levelling-off, Saudi and other GCC producers starting to cut the official selling prices for their October imports, ...), with statistics released last Friday showing money managers had decreased their bullish Brent and WTI oil bets by 124,167 combined net-long positions to 404,914, the least bullish (net-long position still) bet in 21 weeks.

And yet, oil prices are now poised for their biggest weekly advance since early June after Saudi Arabia piled pressure on fellow OPEC+ nations to deliver on promised output cuts. Saudi Energy Minister Prince Abdul Aziz bin Salman opened Thursday's meeting with a forceful condemnation of members that try and get away with pumping too much crude. This week, the IEA said the United Arab Emirates almost entirely disregarded its commitment to quotas last month, while tanker tracking data show Iraq is exporting more crude so far in September than it shipped in August. More importantly, Saudi Arabia also warned short sellers not to challenge its resolve and dropped clear hints that there could be a change of direction in production policy before OPEC+'s next ministerial meeting in December. *“We will never leave this market unattended,”* AbdulAziz bin Salman noted. *“I want the guys on the trading floors to be as jumpy as possible. I am going to make sure whoever gambles on this market will be ouching like hell”* (Oops!). Futures in New York are up about 10% this week, despite bearish calls on the outlook from industry heavyweights such as BP Plc and Trafigura Group to the International Energy Agency. *“All in all, the strong reiteration of OPEC+'s commitment with its planned supply cuts is welcome news to the bulls in the market,”* said Harry Tchilingirian, head of commodities strategy at BNP Paribas SA. Oil prices have also been supported this week by a weaker US dollar and a surprise 4.3 million barrels decline in US crude inventories. November WTI and Brent crude prices last trading at \$41.00 and \$43.15 respectively.

Below, we leave our readers with the two major stories that have shaped our world/markets over the past week:

- **US Federal Reserve Sees rates Near Zero Through 2023:** The Federal Open Market Committee (FOMC) held interest rates near zero and signaled they would stay there for at least three years, promising to delay tightening until the US gets back to maximum employment and 2% inflation. The US central Bank “expects to maintain an accommodative stance” until those outcomes are achieved, it said in a statement on Wednesday evening following a two-day meeting that kept the overnight Fed funds rate unchanged at 0.00% - 0.25%. “This very strong, very powerful guidance shows both our confidence and our determination,” Powell told a press conference following the meeting, though he noted the new strategy was still a bit of a work in progress. “*There is no cookbook!*” (in other words, we’re as clueless as anyone else about the final outcome 😊). The market reaction was a short-lived rally in equity prices and a steepening of the Treasury yield curve. The US dollar was little changed (up on the day, though succumbing to selling pressure over the past 48 hours)
- **UK Sees Brexit Progress:** Contrary to previous signs pointing to a chaotic split between the UK and the European Union without a new trade deal, the UK government suggested that a second round of informal EU trade talks this week were “useful”, as European Commission President Ursula Von Der Leyen told the Financial Times she is “convinced” a deal is possible. The discussions “covered a broad range of issues and some limited progress was made,” the UK government said late Thursday. The positive noises from both sides contrast with the saber-rattling in recent days, as Prime Minister Boris Johnson’s government introduced a draft law to parliament that tore up sections of the Brexit deal he reached less than a year ago, and the EU threatened to retaliate with legal action.

Disclaimer

It is important that you only use this report if you are the intended recipient of this report and you have satisfied yourself that you are eligible to receive such information. This report is provided to you because you are one of our esteemed customers and have previously shown interest in receiving the type of information contained in this report.

The Treasury and Investment Management department of Gulf International Bank B.S.C. (“GIB”) have compiled the information in this report. GIB is incorporated in the Kingdom of Bahrain and is licensed by the Central Bank of Bahrain (the “CBB”) as a conventional wholesale bank. GIB's head office is located at Al-Dowali Building, P.O. Box 1017, 3 Palace Avenue, Manama, Kingdom of Bahrain.

This report is intended for the accredited investors, as defined in the Investment Business Code of Conduct published by the CBB. This information has not been reviewed by the CBB or any other regulatory authority in any jurisdiction and neither CBB nor any other regulatory takes any responsibility for the correctness or accuracy for the information contained in this report.

The information contained herein is not directed at or intended for use by any person resident or located in any jurisdiction where (1) the distribution of such information is contrary to the laws of such jurisdiction or (2) such distribution is prohibited without obtaining the necessary licenses or authorizations by the relevant branch, subsidiary or affiliate office of GIB and such licenses or authorizations have not been obtained. The recipient of such information is responsible for ensuring that this information has not been received by it in breach of laws and regulations of any jurisdiction.

This report contains publicly available information only, which has only been compiled by GIB. The information provided herein is on “as is” and “as available” basis and without representation or warranty of any kind. GIB hereby disclaims any representation or

warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall GIB or its subsidiaries, affiliates, shareholders or their directors, officers, employees, independent contractors, agents and representatives (collectively, "GIB Representatives") be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting there from, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of information or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of GIB or any GIB Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. The information here is, and must be construed solely as, compilation of information (unless expressly stated otherwise) and not statements of fact as to credit worthiness or recommendations or opinions of GIB.

This report does not provide individually tailored investment advice. Any materials contained herein have no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. The document is provided for information purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. GIB makes every effort to use reliable, comprehensive information, but we do not represent that it is accurate or complete. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the materials, nor are they a complete statement of the securities, markets or developments referred to herein. Recipients should not regard the materials as a substitute for the exercise of their own judgement. Any opinions are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or groups of GIB as a result of using different assumptions and criteria. GIB is not under any obligation to update or keep current the information contained herein.

The value of, and income from, your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realised.

The information contained in this report is just for informational purposes. Information does not constitute a solicitation, an offer, or a recommendation to buy or sell any investment instruments, to effect any transactions, or to conclude any legal act of any kind whatsoever. GIB does not intend to provide investment, legal or tax advice through this report and does not represent that any securities or services discussed are suitable for any investor. When making a decision about your investments and business, you should seek the advice of professional advisors.

The report may contain statements that constitute "forward looking statements". While these forward looking statements may represent GIB's judgment and future expectations, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from GIB's expectations. GIB is under no obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise. The historical information is provided for information purposes only. Performance figures are calculated before tax (if any) and after deducting ongoing fees and expenses. The performance figures are historical and past performance is not necessarily an indication of future results. Certain amounts (including %ages) included in this document may have been subject to rounding adjustments. Accordingly, figures may not be an exact arithmetic aggregation of the figures to which they relate. The values and forecasts shown represent our current indicative valuations and forecasts of the relevant transactions, currencies, interest rates, commodities or securities as at the date shown. Any value or forecast shown herein is not an indicative price quotation. We expressly disclaim any responsibility for the accuracy of the values or forecasts shown, any errors or omissions in the report

With the exception of information regarding GIB and save as otherwise specifically indicated, the information set out in this report is based on public information. We have, where possible, indicated the primary source of information. We strongly recommend the recipients consult the primary source of information. Facts and views in this report have not been reviewed by, and may not reflect information known to, professionals in other GIB business areas.

This Report, and the information contained herein (save to the extent that such information is publicly available) is confidential and may not be disclosed by you to any other person outside of your organization without our consent.

GIB retains all right, title and interest (including copyrights, trademarks, patents, as well as any other intellectual property or other right) in all information and content (including all text, data, graphics and logos) in this document. All recipients must not, without limitation, modify, copy, transmit, distribute, display, perform, reproduce, publish, license, frame, create derivative works from, transfer or otherwise use in any other way for commercial or public purposes in whole or in part any information, text, graphics, images from this document (excluding publicly available information) without the prior written permission of GIB.