Twitter Thread by Sahil Kapoor

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Why and when the markets stopped caring about the Russia-Ukraine conflict? A short thread■

The news coming in from Ukraine remains concerning with huge losses and humanitarian crisis.

But for the last 10 days the markets seems to 'Not Care' and react to the news.

Read why

Markets become very jittery if they can sense a large financial panic because of an external event.

One gauge to measure what the market is pricing-in is the funding stress indicator.

For instance, the FRA-OIS spread in US measures the funding stress in interbank markets.

The FRA-OIS spread, which measures the gap between the U.S three-month forward rate agreement and the overnight index swap rate, is an indicator similar to the TED Spread.

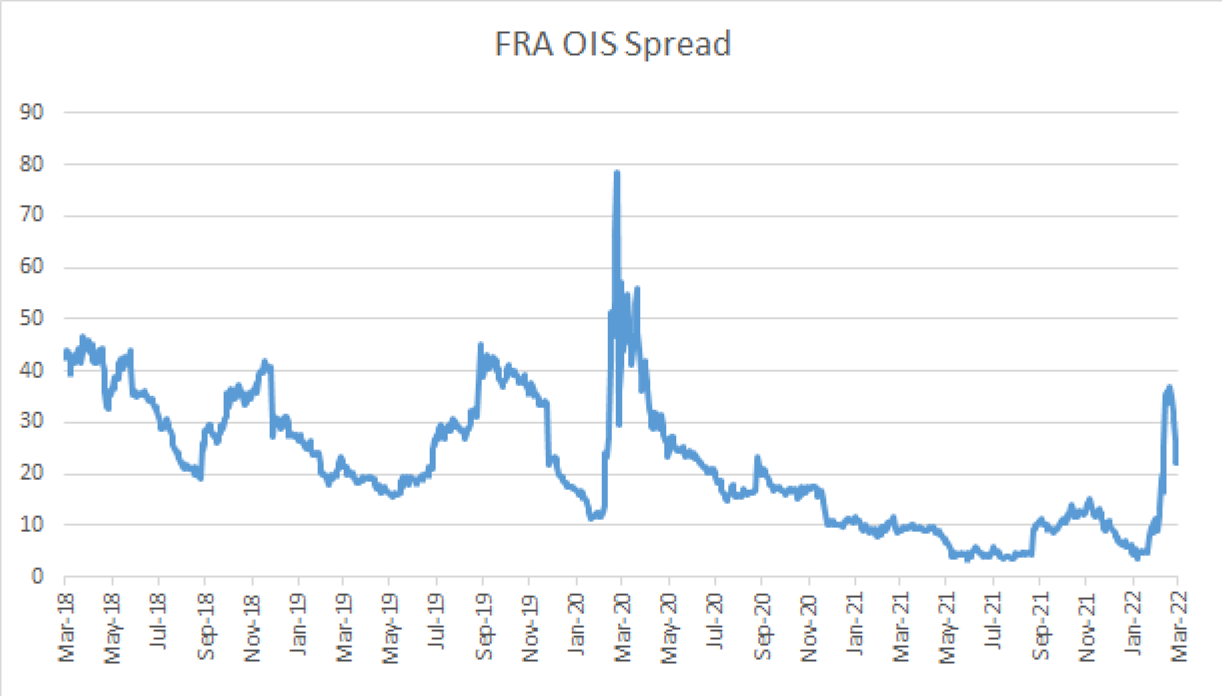
TED spread gained a large analyst following during the global financial crisis in 2008.

The FRA/OIS spread expanded from under 5bps to 38bps since Russia Ukraine crisis began.

The same spread had jumped to 80 from 10 during the COVID crisis scare before US Fed and other central banks stepped in.

Take a look at the graph.

What does this mean?



Equity, bonds and currency markets are most sensitive to problems in interbank markets. Why?

Because interbank markets runs financial markets to a very degree. From margin payment in f&o segment, to short term credit, to credit for economy ....

..to the ability of banks to rollover overnight credit and remain solvent depends on this market.

For instance the US Fed had to step in during the COVID crisis with very large reverse repo deals to maintain the interbank market. Similar trends played out during GFC 2008.

The initial scare when Russia-Ukraine conflict broke out was that a very large section of commodity traders, firms and users will not be able to remain solvent or honor their margins in forwards & futures markets.

This led to a very large uptick in the 'stress indicator'.

Since 10th Mar'22, the FRA-OIS spread began a descent and has declined to levels of 22 from the elevated readings of 38 in early March.

This is no way grantees that the crisis is over but it does indicate that markets assumes this event wouldn't morph into a full blow crisis.

What are the other similar indicators telling us?

1. Crude Oil a backwardation has declined form a peak of 35 to 15
2. A number of commodities like aluminum, nickel have declined 20% or more after going parabolic.
3. VIX (Volatility) indices have declined appreciably globally

How to make sense of this now?

Keep tracking how the FRA-OIS spread moves and the other indicators mentioned in last tweet.

A further slowdown will mean that the event is entirely priced in for the short term.

A reversal will hit the markets again with volatility.

There are a plethora of similar concurrent indicators available to gauge market mood. Most of them move together and can confirm or disprove a hypothesis.

Keep tracking these indicators during these unprecedented events to make better decisions.

More on such indicators later...

P.S.

Keep track of what bond markets are saying.

Look how yield curve has collapsed from where it was 6 months ago to where it is today.

There is a remarkable compression which = Slower growth

Yield Curve (10-2 Yr Bond Yield)	Last	5 Day Ago	1M Ago	3M Ago	6M Ago	1Yr Ago	2 Yr Ago
US	20.5	23.96	45.49	76.04	113.59	154.72	65.18
Germany	70.6	65.11	66.58	33.52	41.26	41.84	51.65
Japan	21.8	21.30	22.10	14.60	16.30	23.70	19.30
UK	28.4	16.97	11.00	24.52	55.53	76.25	44.25
India	182.2	186.24	189.50	195.16	202.03	138.49	