

## “7 Quick Points on Europe”

#1) Here are the most relevant recent notes for an Epsilon Theory perspective on the underlying political and market risks in Europe: [“The Red King”](#) (July 14, 2014) and [“Now There’s Something You Don’t See Every Day, Chauncey”](#) (Dec. 16, 2014).

#2) **Markets reacted positively to last Thursday’s announcement because Draghi doubled the amount of QE that he leaked to the press on Wednesday.** Financial media pegged QE at 600 billion euros on Wednesday and 1.2 trillion euros on Thursday. Once again, Draghi played the Narrative game like a maestro.

#3) **This is NOT open-ended QE.** Sorry, but the Narrative game doesn’t work like this. If you mention a target date (September 2016), then that becomes the Schelling focal point, no matter how much you try to walk that back by saying it’s open-ended.

#4) **Risk-sharing, or the lack thereof, matters.** Draghi won approval of a doubled QE target by minimizing the mutualization of QE risk among EU countries. 80% of the bond-buying will be done by national central banks, and Germany will only buy German government bonds, France will only buy French bonds, etc. That’s important for two reasons. First, if Italy or Spain goes off the rails, then the Bundesbank’s balance sheet isn’t immediately crippled. Second, this is why German bonds are rallying just as hard (harder, really) than periphery bonds. It’s also why US bonds are rallying so hard, because you can’t maintain a huge spread between the only risk-free rates left in the world.

#5) **Market complacency on Greece is a mistake.** Not because Greece itself is a huge systemic threat, but because the same political dynamics in Greece are coming soon to Italy. Greece is Bear Stearns. Italy is Lehman.

#6) **In tail-risk trades as in comedy, timing is everything.** Even if you think that it’s an attractively asymmetric risk/reward profile to bet on a Euro crisis (and I do), this is a heavily negative carry trade. If you don’t know what the phrase “negative carry trade” means, then please don’t make this bet. If you do know what it means, then you know that you either have to play a lot of hands to make the odds work out for you (and the nature of systemic crises makes that impossible) or you have to be spot-on

with your timing.

**#7) In a fundamentals-driven market you need to look at fund flows; in a Narrative-driven market you need to look at Narrative flows.** With Draghi's announcement last Thursday, there is no longer a marginal provider of market-supportive monetary policy Narrative. Or to put this in game theoretic terms, the 2<sup>nd</sup> derivative of the Narrative of Central Bank Omnipotence just flipped negative. We've shifted from an accelerating Narrative flow to a decelerating Narrative flow, and [that inflection point in profoundly important in game-playing](#). The long grey slide of the [Entropic Ending](#) begins.

### To subscribe to Epsilon Theory:

- Sign up here: [www.salientpartners.com/epsilontheory/subscribe](http://www.salientpartners.com/epsilontheory/subscribe)
- **OR** send an email [bhunt@salientpartners.com](mailto:bhunt@salientpartners.com) with your name, email address, and company affiliation (optional).

There is no charge to subscribe to Epsilon Theory and your email address will not be shared with anyone.

### Follow me on Twitter: [@EpsilonTheory](https://twitter.com/EpsilonTheory)

### To unsubscribe to Epsilon Theory:

- Send an email to [bhunt@salientpartners.com](mailto:bhunt@salientpartners.com) with “unsubscribe” in the subject line.

## DISCLOSURES

This commentary is being provided to you by individual personnel of Salient Partners, L.P. and affiliates (“Salient”) and is provided as general information only and should not be taken as investment advice. The opinions expressed in these materials represent the personal views of the author(s) and do not necessarily represent the opinions of Salient. It is not investment research or a research recommendation, as it does not constitute substantive research or analysis. Any action that you take as a result of information contained in this document is ultimately your responsibility. Salient will not accept liability for any loss or damage, including without limitation to any loss of profit, which may arise directly or indirectly from use of or reliance on such information. Consult your investment advisor before making any investment decisions. It must be noted, that no one can accurately predict the future of the market with certainty or guarantee future investment performance. Past performance is not a guarantee of future results.

#### **Statements in this communication are forward-looking statements.**

The forward-looking statements and other views expressed herein are as of the date of this publication. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements, and there is no guarantee that any predictions will come to pass. The views expressed herein are subject to change at any time, due to numerous market and other factors. Salient disclaims any obligation to update publicly or revise any forward-looking statements or views expressed herein.

This information is neither an offer to sell nor a solicitation of any offer to buy any securities. Any offering or solicitation will be made only to eligible investors and pursuant to any applicable Private Placement Memorandum and other governing documents, all of which must be read in their entirety.

Salient commentary has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. Salient recommends that investors independently evaluate particular investments and strategies, and encourage investors to seek the advice of a financial advisor. The appropriateness of a particular investment or strategy will depend on an investor’s individual circumstances and objectives.