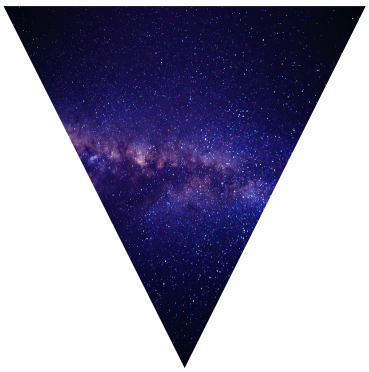
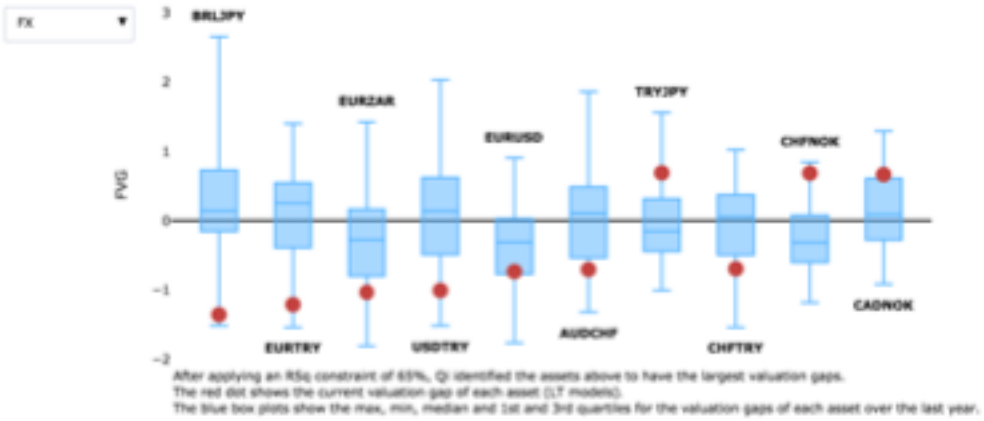
Quant insight



The Upside Down

- Not Netflix's Stranger Things, but the unorthodox policy beliefs of Turkish President Erdogan who argues higher interest rates result in higher inflation. With the Central Bank of Turkey meeting next week, Erdogan is ramping up pressure for a rate cut.

- That has already weighed on the Turkish Lira but it is striking that TRY features four times in the chart below which shows the ten biggest Fair Value Gaps across all Qi's fx models. In all four, **the Lira screens as rich to macro fair value.**



- Both USDTRY & EURTRY are around one sigma (circa 5.0%) cheap to macro fair value. Versus safe havens the Yen & Swiss Franc, the Lira is around 0.5 sigma rich.

- The former two back-test well. Buying USDTRY at a -1 sigma FVG when in regime has, since 2009, produced a 78.6% hit rate for an average return of 3.1%. The equivalent numbers for EURTRY are 70.6% & +0.5%.

- President Erdogan would note that in each model, Developed Market bonds feature as a top driver & lower UST yields, Bunds yields etc are consistent with higher Dollar, Euro. Arguably though this speaks more to a quality dynamic.

- China stress & crude oil are also prominent drivers. Risk off is Lira negative. Domestic Turkish monetary policy aside, **the suggestion is TRY is vulnerable here if you believe markets face a deterioration in risk appetite.**

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