

Chapter 23: The Positional Cleanup:

The futures close from the previous session was 87.79. In the aftermarket SBS had sold/granted 1500 OTC¹ '1 for 3' call options. That meant if the market was above 87.83 15 minutes after the open, there was a good chance they might be exercised, i.e. SBS then sells 1500 futures/FRA contracts or \$150 million worth of 10yr Bond exposure.

If exercised the deal would work via cross' on the SFE floor between the brokers acting for each party. This meant neither party had to stand in the market and bid/offer for the same business. The deal came down to whether the buyers of the call wanted to be 1500 contracts long at 87.83 on the day against their existing positions.

Rudi was planning to be a seller at the .83/84 level to keep a lid on any market advance in those early opening minutes. If it was aggressive, he would back off and let the market decide.

This decision was based on whether he wanted to be hit for that volume, and at that level. The concern was what to do if the market looked to have more upside in it from the previous days and overnight action. His instincts told him that the market had another 10 or so pips to the upside in it today. He just had to try and keep that advance in check until his OTC options expired 15 minutes after the open.

If the market it opened weaker – a whole new set of parameters came into play and the previous days action was going to prove foolhardy at best. Rudi gave this less than a 10% chance given the overnight action and the build up emotion within the market from the previous days closing action.

¹ Over the Counter

Smackers advised that the morning spread between the futures and physical was all over the place as a result of the action the previous afternoon. There were some reports of Institutional buying overnight – and Smackers knew that Rudi had sold \$40 million overnight. That information was their own head start against the market going into the opening.

The consensus from Smackers is that nobody had any idea where futures were going to open. The market had no idea what the volume or price dealt on the overnight stuff and Smackers was helping feed the rumours.

Based on the fair value spread price, it was easy to benchmark where the futures price should be in relation to the physical market. However, right at that moment, nobody knew what either value was. Smackers told Rudi the physicals were neither bid nor offered and everybody was waiting to see the futures open.

'Fuckin' jimmy roots ...' Rudi thought to himself. What else could he think? He only had himself to blame.

The market was not gonna make a move until Rudi showed his hand in some way. It was a bitch having to make the pitch/play all the time. He would love to be the one who swung at the pitch. He'd rather the opportunity to counter punch and have a target to go after.

The market gossip about the events of the previous afternoon remained wildly speculative. They ranged from the obvious SBS involvement, to AMP making it look like a SBS trade, to an overseas player dumping their position, and another domestic doing the buying. In reality and given that there had been no real physicals traded, there could only be one opinion to any serious market operative.

Rudi knew that the smart people in the market knew that it was SBS. He also knew they were now waiting to see how the day played out and whether the SBS had poked his head out too

far. There were plenty waiting for that opportunity and both sides knew that if it came, it would be ugly.

Rudi knew he was the guy hiding in the maze everyone was looking for and his task today was to stay out of sight as best as he could.

The last thing he wanted was to draw a bigger target on his back. Hell, it was theatre - and these circumstances are what Dealers live for. Right now the spotlight was on him and he was the - *'hare in the glare'* and whatever he did today, everybody who was anybody would be watching - perhaps even some regulators if they knew what was afoot.

There was no way he was going to play the physical market - at least not early anyway. He wanted and needed the SBS's Jan '98's physicals to stay out of sight for a while longer as part of his bigger plan.

'It had to be done with options and futures, with some market intimidation' were his current thought patterns.

The market was opening and going through its pre market bid/offer routine. Claudio was on the phone and he had no instructions from Rudi.

From Rudi's perspective and if he was on the opposite side of this play, he would attack the market. If the market had any balls they should have known that this is when they should attack. To date, the market had never shown any balls when it came to countering any SBS's market play.

The market's past responses was a part of the reason Rudi knew he could push and shove them around. He knew this and the rest of the market knew this. He would have to take advantage of this fact today to help get control over his over exposure. In many ways Rudi was exposing and educating the market in ways they were still unable to understand.

Traders who knew him from his Brisbane days would often refer to him as someone who had - 'balls like and elephant'.

The opening trades on the futures market showed 87.80/81 bid/offer. This would piss off the OTC call option buyers on the opposite side of the SBS position. They would now have an agonising choice about whether to exercise their option call positions. Three or four points higher and the decision would be clear, now it was a line ball call.

The traders that were still short from yesterday activities were in some more pain. The technical traders would be sellers on the overnight profit they were showing.

The market opened, traded 87.82... 83... 84 trading and 400 lots done... back to... 83... 82 bid, offered... 84. Rudi's mind was in overdrive, does he or doesn't he.

'Fuck it,' he said and put Claudio's phone to his mouth and released the mute button,

'Offer the market at .83 Claudio ... do up to 150 lots without any probing ... just sit there and squat on the buyers.'

Claudio put the offer in the pit through Phil ... nothing done ... '.81 bid was the comeback'.

Rudi did not want to give up the option premium easily ... he wanted to make the decision a tough one for whoever had to make it. There was another 10 minutes to OTC position expiry.

The market marked time, Rudi was not going to expose himself today, he could feel the size of that target on his back getting bigger. He kept telling himself to let the market decide ... let the market decide ... he was happy to hold the position at this level.

Smackers made a comment to try and ease the tension in the room. Nobody heard what it was – just nervous energy ...

If he wanted to get his 1500 sold contracts, all he had to do would was let the market go bid on its own merits, or bid it himself to force the decision from the other side of his Call option

position. His market instincts knew he had the market on the back foot. In his opinion it was still a 90% call in his favour the way the market faced up right at that moment. Whilst he had those odds, he was not about to contemplate any leakage from the position he had.

'Claudio, don't let it trade above 87.83 – do whatever you need,' Rudi said into the mouthpiece.

Claudio was not privy to what the whole picture was. He was carrying out instructions and he had proved himself many times to Rudi that he was the man for his business.

Rudi started to look at some of the revaluations in the physicals and the futures from this morning updates. The portfolio showed over \$2 million in revaluation profits on the trading stock from the overnight move from yesterday's levels. Rudi knew that could all change very quickly if he got it wrong in the next hour or so.

The futures had not traded at 87.83 from when Claudio offered it.

The market was respectful in that the offer was coming from Bains – Rudi could see in his own imagination that Claudio was growling at the market and the market knew what that meant..

This was the leverage Rudi meant when he said he could use the relationship with Bains in his favour.

The market traded down to .81 and was currently .81 bid and .82 offered. There were only a few minutes to go until the OTC expired.

Market was still, no action, Rudi's phone from the OTC broker rang and was told, 'No business done on all three deals.'

That made Rudi feel a little easier... not a lot, but \$90k or OTC premium just kicked into the SBS coffers.

The futures remained the same and Rudi told Claudio, 'off the offer.'

There had been no business done – and this confirmed to Rudi just how skittish the market was – he had them all on a leash at the moment.

The read Rudi got from the OTC outcome was the player on the other side might become a seller in the market to support what Rudi thought might be his existing position.

That could spell trouble for Rudi.

He asked Claudio, 'What is your read, any feel for the mood of the pit?'

Claudio was not so eager to let his opinion go at this point ... he was unsure and had a feeling that all was not well with Rudi and his position from yesterday – he never mentioned it and waited for his instructions. You could cut the tension with a knife.

Rudi remained silent - he did not want to give an indication to Claudio one way or the other. Claudio never prodded and this type of unpressured response is what made Claudio the best floor broker around.

In reality, the market was on a knife-edge and Rudi was looking for a market indicator – he still wanted the market to give him a sign.

Claudio could feel Rudi's angst tried to break the silence when he said, 'it's only fuckin' money.'

One could always count on Claudio to make an understatement.

As the minutes ticked away, the day was revealing nothing – traders were sitting back waiting for the first sign -

Similarly Rudi had no real read on the other dealers and what they were likely to do other than what Smackers was feeding him. He relieved some tensions when he advised the physicals were showing some bid activity based on futures pricing and sellers were scarce. No real indicator there either, but that was good news.

Rudi's mid-morning appointment with the other Building Society Treasurers was cancelled - he rang Bartlett himself and advised he could not make it. Bartlett was the friendly type accepted the apology and then tried to engage in a conversation.

He surprised Rudi when he asked straight out, 'was that you in the market yesterday afternoon?'

Bartlett had showed his hand and Rudi knew he was fishing. The question was completely unexpected and Rudi had no immediate response. His mind was far removed from the conversation and his was focused on the current predicament.

The call was made as a courtesy and now he was distracted. He did not know how to answer the question ... he did not want to answer the question ... or even think about the question.

He asked Greg, 'what have you heard?'

It was the best he could think of at the time.

Greg said, 'the only thing talked about at the market function I was at last night was what happened in the futures yesterday afternoon. Everybody said it was you.'

Once again, Rudi was caught off guard and was not sure how to respond. He had no idea how well Greg was hooked into the market gossip sources. He did not want to have this conversation and was thinking quickly how to get away from it. It was good to hear about the gossip levels, but ego stroking was not what he wanted right at that moment.

'Greg, I am really busy now, can we reschedule the meeting or can you send me a copy of the minutes?' He just ignored the question from Greg.

Greg just said, 'Ok, I'll speak with the other members and let you know about a reschedule. If not, I'll send you a copy of the minutes.'

'Thanks Greg, talk to you soon, gotta go, cya,' and Rudi cut him off.

The trouble in a market this thin and as focused at this market was, meant any move Rudi tried to make in a non aggressive way, would be seen as limp-dicked and weak. He knew if he came out as a soft seller and tried to chase the market down to get set for the volume he needed to do, the market would collapse on him. That would mean yesterdays efforts had been a waste of time.

He rang Manny from Schrodgers and had a quick chat and asked him whether he was making prices. This far out from the March '88 expiry, the time premium on March calls and puts was still healthy but on the move as each day ticked off.

Rudi had a soft opinion that the contract would expire somewhere between 12.25% (87.25 Futures Price), and 11.75% (88.25), but most likely the 12.00% (88.00) strike. He would target one of these if he fully committed to his strategy.

His call to Manny was a part plan in that he had to try and get someone to enter the market as a buyer and take some pressure off him. Manny from Schrodgers was a thought in that direction.

The 87.75, 88.00 and 88.25 calls were priced in a way that indicated the market was bid more than offered. If Rudi sold/granted the calls, he was offering the right for traders to buy at those levels. That meant Manny would have to sell futures to square his position.

If he offered the puts at the same strike prices, they were mostly in the money except for the 87.75's and the premiums were far greater. If Rudi's call was for yields to continue to drift lower, granting puts was a far better proposal if he ended up being right. It would not have any impact in reducing his overall exposures, but only increase his net long position. That was the immediate negative.

To push Manny to buy futures he had to get him net short in the market, either by him buying puts or selling calls. There was

just too much risk in going naked on options this far out - Rudi's intention was to use the options from early March when the spread became more focused, and the time premium was more measured as was the spread value.

Rudi was scratching chalk boards trying to think of a solution to the day's crisis. He asked Smackers for any ideas.

It was beyond Smackers given his short stint and exposure to what Rudi was up to and Rudi knew this. Smackers knew Rudi felt he was in trouble and he just had no answer to the current problem. He had no idea what Rudi was up to the day before, other than it was an initial chart play to which he agreed.

Claudio's line rang and Rudi snatched it up quickly, 'Hey, we just heard a rumour that BT² was the big buyer yesterday afternoon, and, they will be buyers again today.'

Claudio had no idea how good that news was for Rudi. For all Rudi knew, Claudio might have started the rumour himself. But why would the market think that BT would be buyers through Bains unless they were trying to make it look like an SBS trade?

Rudi and Claudio both knew the truth, but a rumour like this could only help. The strength of the rumour would dictate how the market reacted. He would ask Claudio about where he heard the rumour later.

The market had been open 45 minutes and less than a 500 lots had traded. The futures remained .81 bid and .82 offered. All the business was Locals and the pit was starting to get bored. This was dangerous from Rudi's perspective. It meant that the market was long and any selling would start an avalanche.

SBS had to be a net seller on the day to reduce the SBS exposure. As soon as the market saw SBS as a seller, game over.

² Bankers Trust Australia

This was as tough a position as Rudi had ever been in for some time. His Management had no concept of the strategy currently in play. The clock was ticking and all Rudi could do is play the wait game and try to let the market decide his fate.

That pissed Rudi off even more, his fate was in the hands of the traders who had no idea just how vulnerable he was.

10:00 am rolled around – market was had been open for 90 minutes - the physicals were showing some bids but there was little business being done.

Rudi snapped to focus and asked Smackers to let \$20 million of the SBS Jan '98's go and to do it in small parcels across the brokers – he said to offer it at 2 pips over the spread value. Rudi had about another \$200 million worth of physicals or futures to sell, about 2000 contracts, and on a day like this it was going to be like pulling teeth.

Smackers reported that the stock was taken quickly. That perked Rudi up.

He asked Smackers, 'Have the brokers reported the seller details yet'.

Smackers replied, 'no, not yet.'

The spread to futures on the stock sold was 7-9 pips. Smackers had sold at 12.25% yields and the market was now bid at 12.25% for another \$50 million.

Rudi told Smackers, 'Hit that bid'. He did, and the market went quite again.

Rudi felt there was a corporate client out there with a \$100 million buy order and the trader who had the order was working it to a spread over futures.

He rang Manny from Schroders and asked, 'Manny can you give me a quote in 87.75 calls and puts for 500 lots.'

Manny said, 'I'll be right back.'

Rudi told Smackers, 'offer another \$30 million at 12.20%.'

This was Rudi's attempt to draw the buyer out and see how aggressive he was.

Manny came back and gave Rudi his quote, 'Calls, 7-9, puts, 11-13.'

Rudi said, 'I sell 500 puts at 11.'

Manny responded to confirm the deal, 'OK, you sell, I buy 500 87.75 puts at .11, I'll let the futures boys know to do the cross.'

This meant that Manny would have to buy futures to get his cover. Rudi rang Claudio and told him about the Schrodgers cross he had to do.

Next thing heard was, '98's taken at 12.2%' screamed across the squawk box and the futures went bid almost straight away.

Schrodgers were the main buyer and the market was trading .84... 85... 86 and bid over. Based on the spread to physicals, futures should be 87.88-90 or so ... the markets were still not in tandem and Rudi thought this was an opportunity developing.

He rang Claudio, '... the market is bid,' Claudio offered before Rudi could say anything.

'Want you to gently sell 500 into this strength and make it look like anything but an order from me.' Rudi was being careful and wanted Claudio to understand what he wanted exactly.

'Don't go offered, let it come to you and do nothing but 50 lots at a time,' he barked.

Claudio got the message and said, 'hear no evil, see no evil.'

Rudi said, 'fuckin' smartass,' and was not sure whether Claudio had heard him, he was gone and Clare was on the line.

Rudi spoke to Smackers and asked him to work the market and try and find who the real buyer might be. Smackers had

given over the SBS details and he said he thought from what he had heard it was an overseas institution.

With the \$40 million from last night's sales, and another \$100 million in physicals already today, Rudi had the pressure valve locked on open. The \$140 million in sales had taken just 4 deals and one of them was overnight. The stock was not going into traders hands, they were the back end of some swap or hedge deal that was not going to have any real impact on Rudi's bigger plans.

The futures market was getting some volume done as it wound past 11:00 am and looked to be building some momentum. This was also good news for Rudi, the market had let him off and he was feeling a lot more comfortable and was lightening up. Michael, Sean and Smackers saw the release and they also responded.

He rang Claudio to get an update, 'We've done 400 of the order, we will get the rest, it is well bid under and will probably go through 87.90 before lunch.' This again was good news for Rudi.

Rudi rang Manny and asked him, Manny, 'Can you give me a price in 87:75 calls and putts for 500 lots.'

Manny said, 'Another lot or you looking to close out?'

Rudi responded, 'maybe both, not sure yet.'

'I'll come straight back,' Manny said and hung up.

A few moments later Manny came back and said, '9-11 the calls and 9-11 the puts, but if you hit me, you have to let me get futures before you do anything.'

Rudi understood Manny's want to get his futures, the market was on the move and he did not want to be left on the fence and his ass hanging out there.

'Nothing done Manny, thanks, wanted the price value for record purposes.'

'The volatility has shot up since yesterday and this morning and has pushed fair values higher,' offered Manny.

'I might be back this afternoon to do some,' Rudi responded.

Rudi could have checked those numbers on his own option program Manny had given him a few months earlier. It was easier to just ask Manny and get real dealing quotes he could respond to while doing so. The market was trading 87.87 and remained bid over.

Rudi buzzed Claudio, 'Want you to sell another 500 into the stops above .90 when they go off, just keep backing off OK. Oh, and Claudio, gently ... gently OK.'

Claudio understood and said, 'gotta go... .88 trading.'

The market closed at lunch at 87.885 and had a high of 87.89. Claudio advised Rudi he got his 150 and 650 in total for the morning's activity.

All the morning angst had disappeared and nobody in the market knew how close they were to causing a big reversal of fortune for the SBS.

The SBS desk was cruising again and the joviality had returned. This high/low ebb of the emotional roller coaster ride was what dealers dealt with every day. The 'market lunch' was one way to get the juices flowing and ready for the afternoon session.

Rudi said to Claudio, 'I'm taking the boys down to Harpoon Harrys for a long lunch, you want to join us ... SBS treat?'

'Sure, see you in about 20 minutes.'

With the \$140 million of physicals and another \$65 million in futures/FRA's gone, Rudi had pretty much got out of jail and would book close to a \$1.25 million in profits from the activities since yesterday afternoon. The options he did with Manny were part of the bigger plan and he intended to keep them for the time being.

The sell down and buy up from last night, and the match outs of those 1st in 1st out trades showed just under a \$250k loss. Rudi was very happy with the \$1 million net result and so would his Management.

Claudio rang Rudi on an outside line just before lunch and told him Cullen had said that everything was sweet. They did some switches in-house to cover the ICCH requirements. Everything just rolled to the centre Rudi thought - balance was again restored.

Rudi went out to see Sue and asked her if she was OK for lunch. She was eager and said she would join them all. Sean was left to man the phones, his turn would come.

It ended up being a long lunch for Smackers and Rudi. Sue left about 1:30 pm to get back and see to the afternoon settlements. Michael left about 2:30 pm to make sure the cash book ended up OK. Claudio left when Sue did to make sure he was back on the floor in time. Rudi and Smackers settled in and they walked back into the office about 4:00 pm and it was as if yesterday afternoons antics were a distant memory.

There was a message from Quartermaine from FIB and Rudi would talk to him later.

The market had drifted off all afternoon on little volume and was back at 87.83-4 and the physicals were offered at 12.25% and Rudi was not surprised.

He learnt that the \$140 million was gone, bedded down with an overseas insto via an Aussie based trader from the market. That meant \$500 million or so of the Jan '98 stock was locked down and only \$400 million remained in market hands with the RBA holding another \$100 million. Of that \$400 million, SBS stilled owned just over \$100 million. That was still more that enough and a good platform to launch the futures strategy.

Rudi's only concern about the amount of stock out there, was there needed to be enough to average \$5-\$10 million for

each traders stock position to keep it turning over. Rudi had that covered in his plan. He would become a lender of the SBS owned stock to help the market trade from a short position if they wanted.

Quartermaine from FBI would never know just what Rudi's position turned out to be. From what he was seeing the next day, SBS were a monster winner basis where the market levels went to the next day. That was the rumour that went round and fed its way back to SBS via brokers.

Smackers had a serious word with Rudi over their lunch when they were alone, and told Rudi he had been, 'Fuckin' shit scared since yesterday.'

He had never been exposed to such raw emotion and adrenalin as what he felt watching the whole thing unfold. He told Rudi that he was a 'fuckin' lunatic,' in the nicest possible way.

Smackers was just reacting to the real world of dealing in an environment where you punted your limits everyday and were not scared to do so – not that SBS had any real Management Limits. Maybe he would not need the 'coke' so much to make him feel alive.

Rudi heeded Smackers words of wisdom and he was already aware of how close he came to dumping it all. That result would have been a far different outcome for SBS. During the rest of the time at lunch, Rudi gave Smackers a complete picture of his futures plan. Smackers had a few questions, but for the most part he was just all ears over his exposure to the market from the SBS perspective. His learning curve was steep and he was not afraid to admit it.

The balance of the month was quiet by SBS standards. Rudi thought it best to let his profile wind down given what he was planning. The trading all through this period was Smackers, and was completely linked to the spread between futures and

physicals. They continued to educate the market in accepting the Jan '98's being the benchmark for the Mar '88 futures pricing. Smackers job was to provide the liquidity to the market using the SBS holdings of Jan '98's.

The Mar' 87's and Sep '97's were still trading, but their spreads were well outside the futures/Jan '98 spread. All the markets trading was now in Jan '98's and this ticked another box on Rudi's checklist.

They continued with the overnight OTC options and by month's end had pulled in \$800k in premiums. The hedge and CGL trading matched each other out and Michael had made some Bank Bill profits in his own discretionary trading.

Rudi spent the last few days of the month preparing his presentation to his Management that explained the futures strategy in every detail. It had to be simplified without the market jargon so they would be able to understand it clearly.

The 'play' was still not set in concrete at this stage and could be pulled at any time. Rudi still needed some things to fall into place before he would commit 100%.

The January '98's had dipped 15 pips in yield towards month's end and the option strike price Rudi was going to work on was still not obvious yet. It looked like being the 88.00 series.

February was no other very good month for the SBS Treasury. The whole Treasury function was working like clockwork and was a very settled operation. Every member knew his or her role and nobody was misplaced. They were all working hard and there was enough upside in everyone's position to keep everyone interested and keen.

Rudi was very proud of his small Treasury team and his operation. He was 100% sure there was no better operation around. He was looking forward to handing them all their bonus cheques when they arrived after the March closeout and end of year results.