Trade Radar

Trades & Fades

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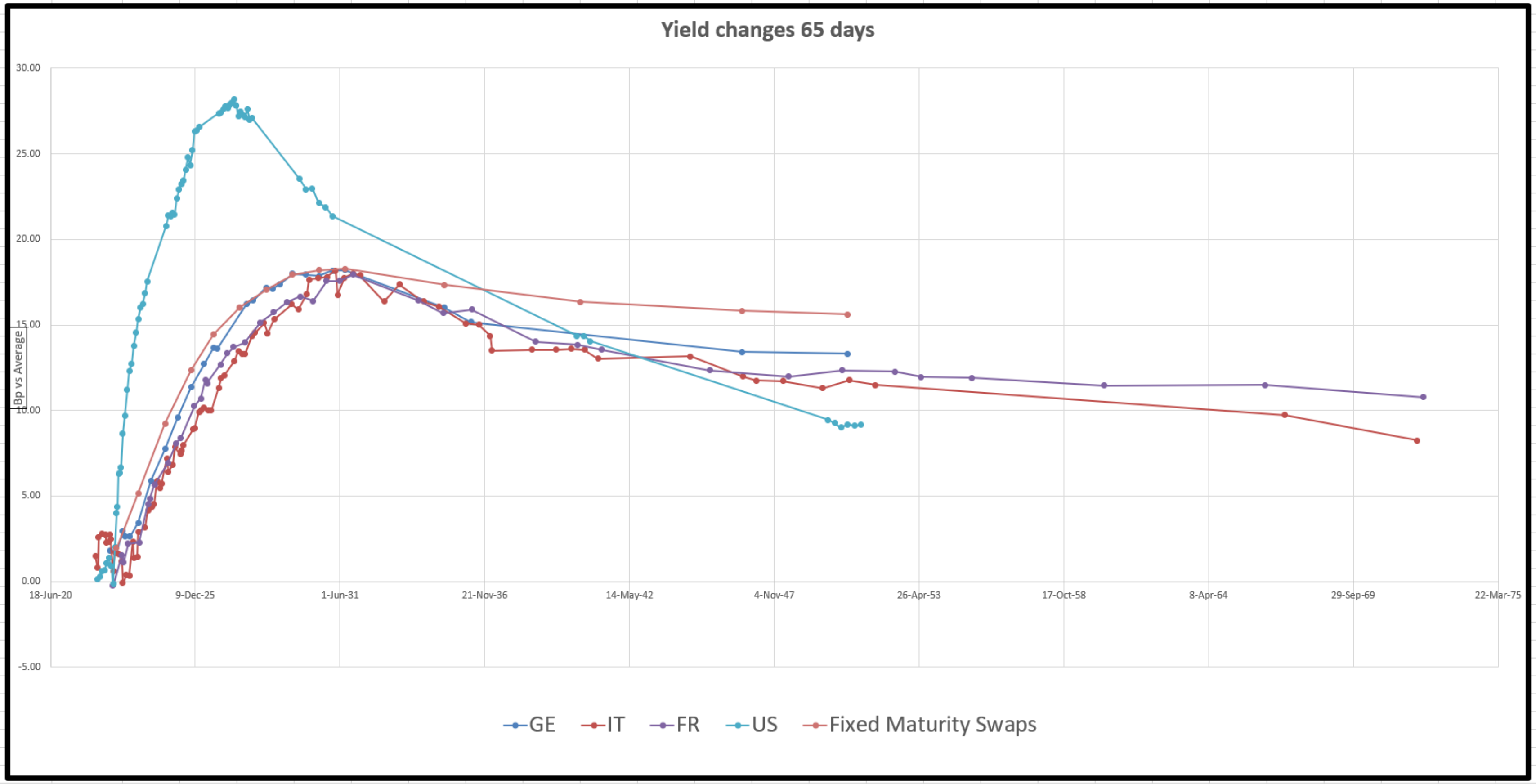
18th Oct

- Risk seemed to decline as major Sharpe Ratio Trades came off our radar monitor
- Still cautious – we like delta and 10y bullets vs wings – but the latter demands a net delta short in EGBs
- UST curve leading the way in 7y sell-off

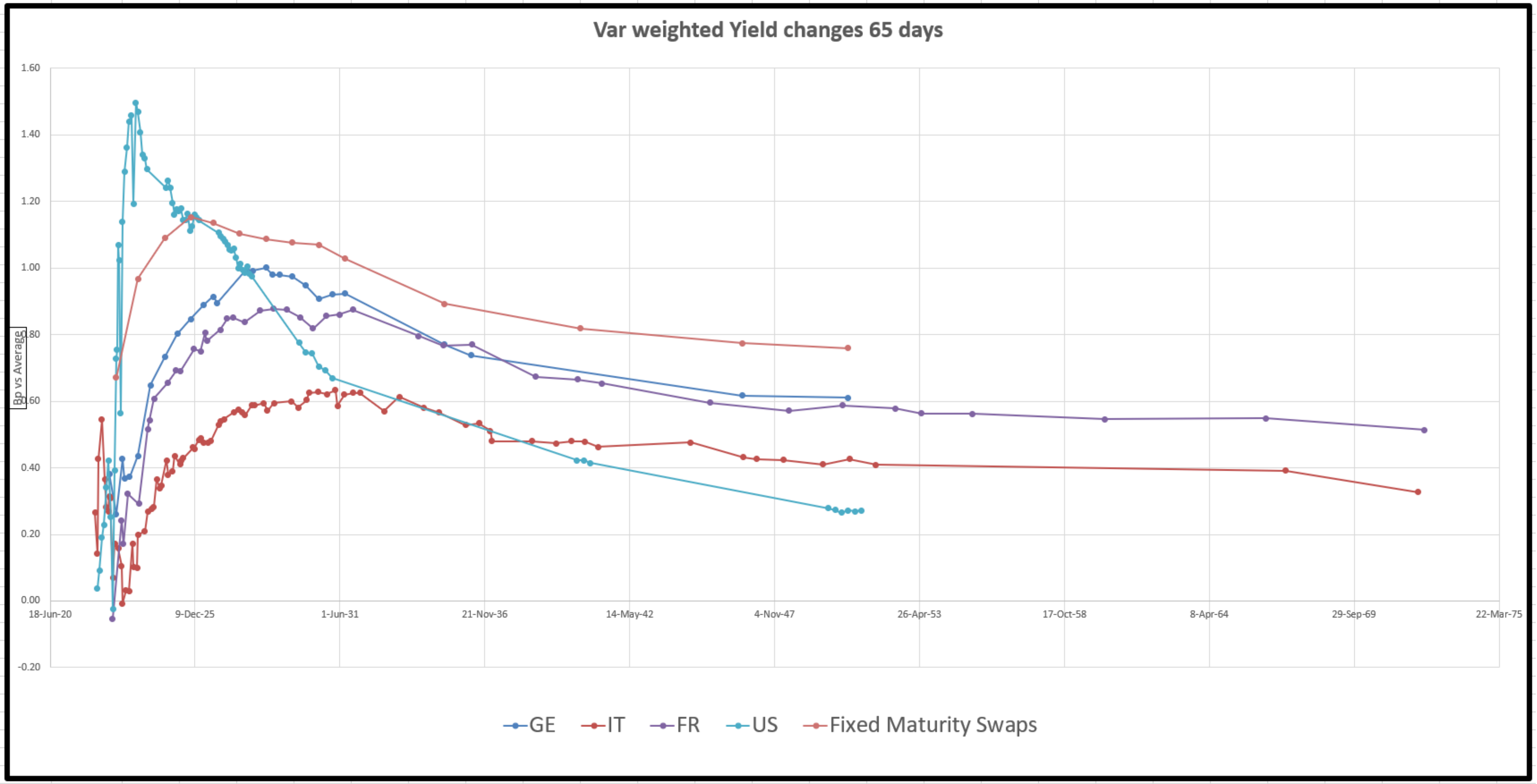
Here's a graph of the moves vs the Average yield over the last 3months (65 observations)

- Bear flattening of the US curve has been the biggest response with 7yrs getting hit the most –
- A posteriori, the explanation is that although the FED will leave the punchbowl at the party for longer, it will react more severely later down the road – so forwards like 5y2y and 3y2y have been hard hit, rather than the very tenors



Let’s look at those same moves, Var adjusted – so: (current price – 3mo average) / 3mo vol

- When we volatility adjust the yield moves, we can see just how extreme the cheapening in 2-3 yr UST has been ***relative to its previously benign behaviour*** – this is a ‘sea change in the curve modality’ – a **trend towards bear flattening**
- Also, post the last ECB conference – Italy (and other peripherals) have exhibited similar moves as core but with a larger historical vol and hence outperformed on a risk-adjusted basis – we think this continues until vol adjusted carry is equal and hence favour narrowing
- The generic narrowing has precluded France from significant widening (idiosyncratic election fears) – in a Bayesian EGB spread context, we expect to see continued spread narrowing in absence of major shocks



Fades

Looking for more flattening that’s out of line with the vol adjusted curve – particularly 7s/10s in EGB

Looking for spread tightening in markets with depressed vol from the PEPP

Taking profits in 10s20s30s structures

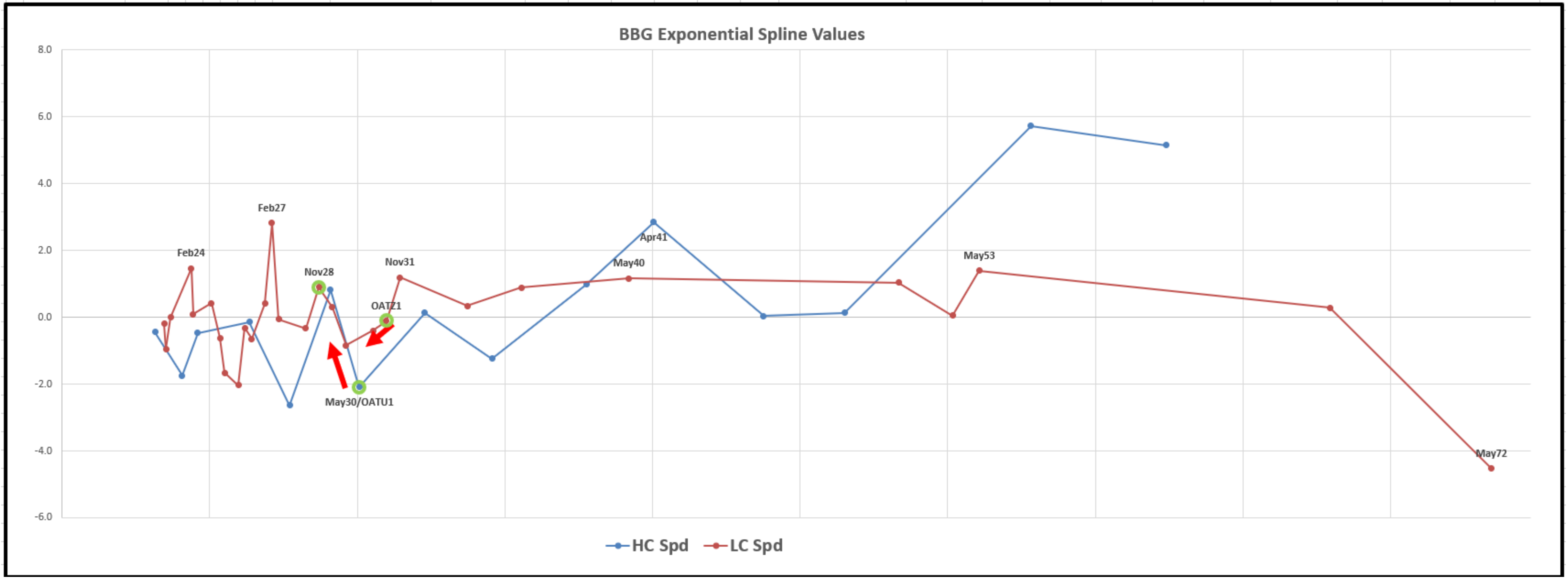
Forward rate steepeners where the local forward rates are flat in the context of a wider curve that is upward sloping – E.g. US 5s7s10s

Trade 1
Italy: -5y / +10y / -15y

- Weights: -1 / +2 / -1.2
- Enter: -1.5bp (50% risk)
- Add: +2bp (50% risk)
- Target: -9bp
- Daily Vol: 0.9 bp
- Nett delta short: protection against Low Coupon Short
- Carry: -0.25 bp /3mo, @ -5bp repo spread
- Roll: +0.1bp /3mo (no tuck-in/anomaly roll)
- Current Mid: -0.85 bp
- Estimated one-way Friction: 0.7 bp

Trade 2
Sell old OATU1 CTD vs old 7y & OATZ1

- We said that the outgoing OATU1 Ctd – Frtr May30 could richen on the drop out
- Its high coupon gives it value that you can really only see when look at Bloomberg discounted Cash-Value (BB_SPRD_TO_SPLINE_EXPONENTIAL)
- looking at yields is insufficient for the purpose, but finally the issue is rich



Sell Frtr May30 continued…

- Weights: +0.4 / -2 / -1.6
- **Enter (on Order): -10.8bp (25% risk)**
- **Add: -11.75bp (75%, risk)**
- **Target: -9.2bp**
- nov28 / may30 / OATZ1 flattener
- Predominantly flattener may30 vs May31 (=> OATZ1 Ctd)
- Carry Flat: using implied repo as cheap funding edge on Long Leg
- Roll: -0.25bp /3mo (no tuck in, May30 could cheapen to where Apr29s are in real terms)
- Current Mid: -10.8 bp
- Estimated one-way friction: 0.3bp (using futures long leg)
- Daily Vol: 0.2bp

Bit tactical – vol isn't high – so it's a quick in and out on modest size. Scale if it gets really interesting

(+2.0 * YIELD[FRTR 2.5 05/25/30 Corp] - 1 * YIELD[FRTR 0 11/25/29 Corp] - 1 * YIELD[FRTR 1.5 05/25/31 Corp]) * 100

Trade 3
US 5s7s10s: fwd steepener
5y2y too high vs 7y3y

- TYZ1's underperformance has been like throwing the baby out with the bath water
- For the UST curve, I get the following picture of forward rates
- In an otherwise upward sloping forward curve, the bond curve TY/UXY is too flat

Bond benchmarks	Yield	shift (bp)	used yield	Fwd vs Prior Bond	US Swaps Bloomberg FWCM (fwds)	spread fwd bond - US Swaps
B 0 11/16/21	0.032	0	0.032			
B 0 12/14/21	0.071	0	0.071	0.112	0.049	0.063
B 0 01/13/22	0.047	0	0.047	0.001	0.160	-0.159
B 0 04/14/22	0.053	0	0.053	0.059	0.164	-0.104
B 0 10/06/22	0.103	0	0.103	0.153	0.313	-0.159
T 0.25 09/30/23	0.396	0	0.396	0.686	0.842	-0.156
T 0.5 02/28/26	1.035	0	1.035	1.557	1.601	-0.043
T 2.875 08/15/28	1.374	0	1.374	2.033	1.898	0.135
T 1.625 05/15/31	1.547	0	1.547	2.012	2.008	0.004
T 5 05/15/37	1.718	0	1.718	2.095	2.075	0.020
T 3 02/15/47	2.028	0	2.028	2.734	1.952	0.782
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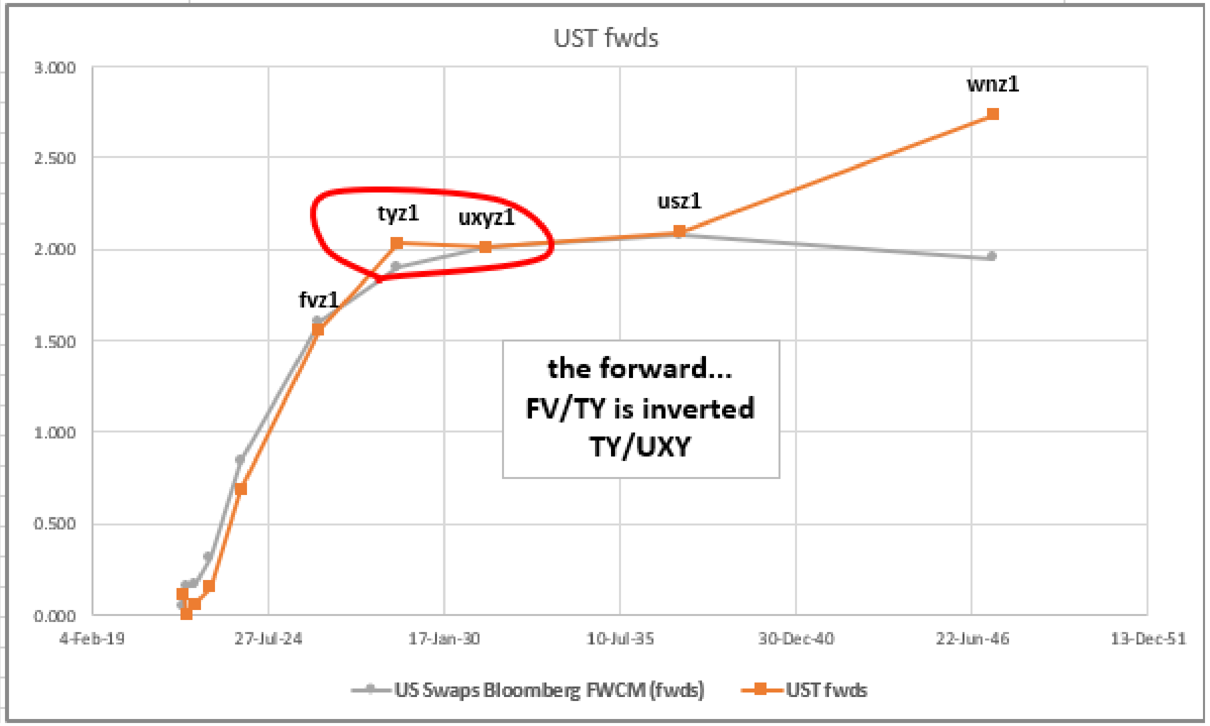


Trade 3 Hedging
In this trade we have to weight it to capture the forwards

- Forward hedging – so to capture this value, we need to look at the construction of two forward rate trades – the 5y2y and 7y3y – individually they may not be duration matched
- We empirically 'perturb' each of the components to calculate the sensitivity of forward rate structure and so derive the weighting scheme

(2 * YIELD[T 2.875 08/15/28 Govt] - 0.65 * YIELD[T 0.5 02/28/26 Govt] - 1.35 * YIELD[T 1.625 05/15/31 Govt])*100

CTDs
FV: T 0.5 02/28/26 Govt
TY: T 2.875 08/15/28 Govt
UXY: T 1.625 05/15/31 Govt

Trade: -FV / +TY / -UXY

Level: -1.5bp (50% risk)

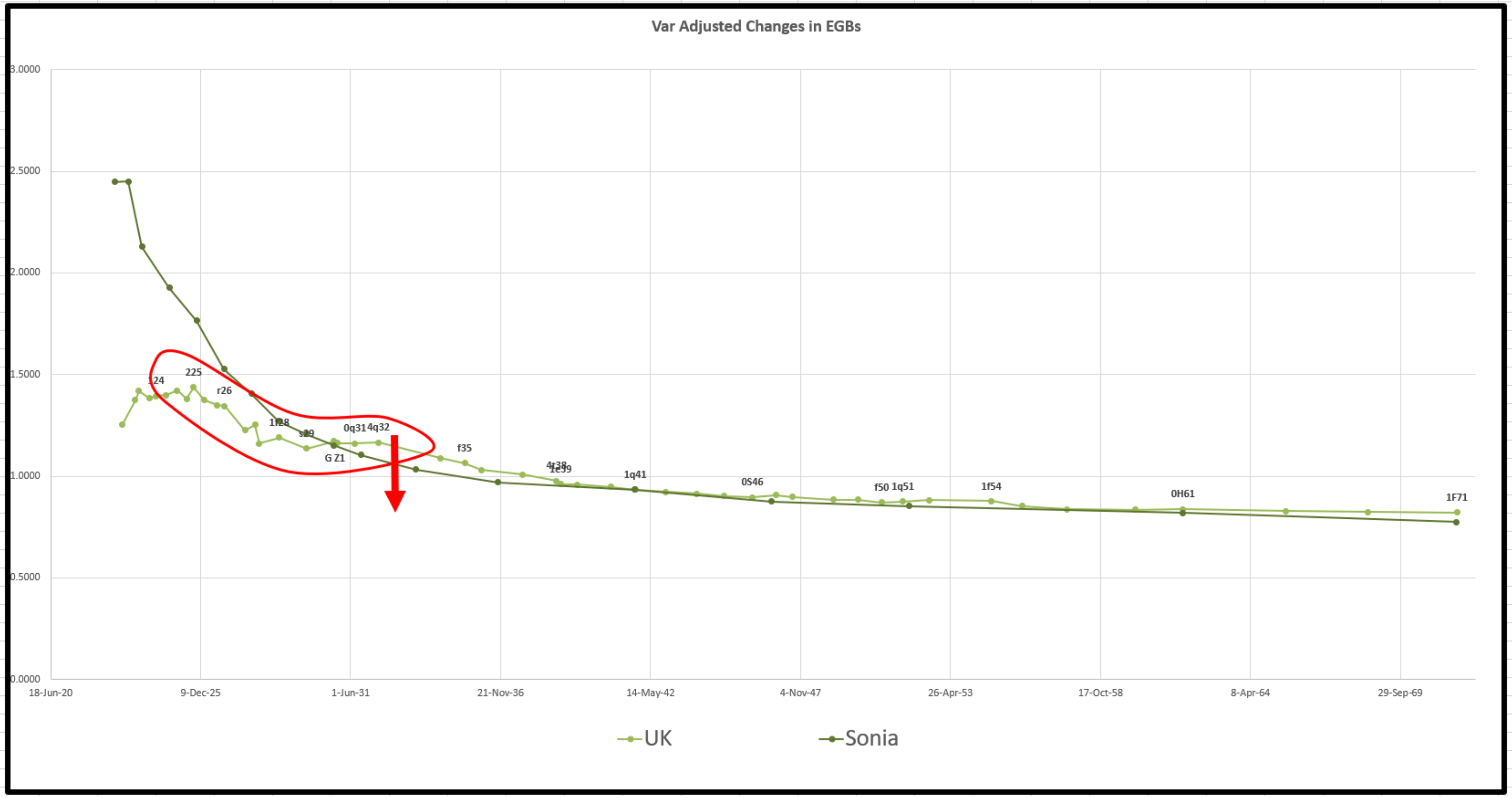
Add: +2bp (50% risk)

Daily Vol: 0.8bp

Ukt – 10y left behind as market flattens curve

- What's remarkable is how orderly the moves in UKT vol adjusted in longer tenors (>12yrs have been,)
- In shorter bonds, that reflect the change in rate outlook, there's a need for re-alignment
- Generally there's been a flattening – but the hedge instrument (G Z1 and Far CTD, UKT 32s) feel oversold
- Conversely the 7yrs have done pretty well
- Notwithstanding the new low coupon 10y supply (2032s) mid November we like 10yrs as a long wing…

(3mo changes minus average) / volatility



Trade 4
Long Far CTD 32s & Ukt 2s25 vs Short Ukt e28

- Weights as per regression on changes 'how it trades' +0.8 / 2 / +1.2
- Enter: -20bp (33% risk)
- Add: -22.5 bp (67% risk
- Target: -15.75bp

Has had a lot of vol – I think we're going to see this more and more of this in risk – nibble at a trade at first – if it works we should have many smaller structures on – if it goes against we're joyous to add…

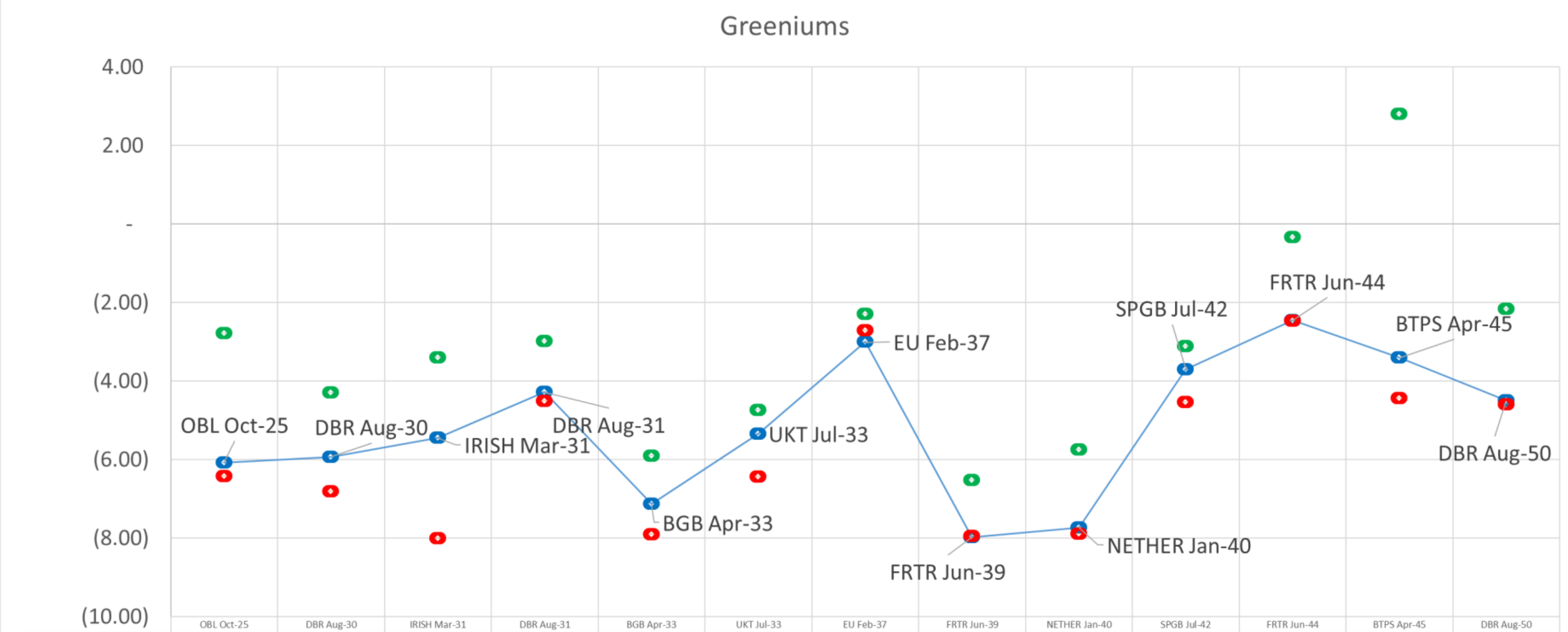
- Carry: -0.6bp @ -15bp repo spread
- Daily Vol: 0.6bp
- For Bloomberg spline values on the UKT curve please call
- Always like a cheeky long in 2s 25 – sticky bond

(+2.0 * YIELD[UKT 0.125 01/31/28 Corp] - 0.8 * YIELD[UKT 2 09/07/25 Corp] - 1.2 * YIELD[UKT 4.25 06/07/32 Corp]) * 100

‘Greeniums’
– premia for the Green label, ***‘get long, cheaply’***

For those of you who haven’t seen it, Will did some fantastic work on Green premia in EGBs and UKT

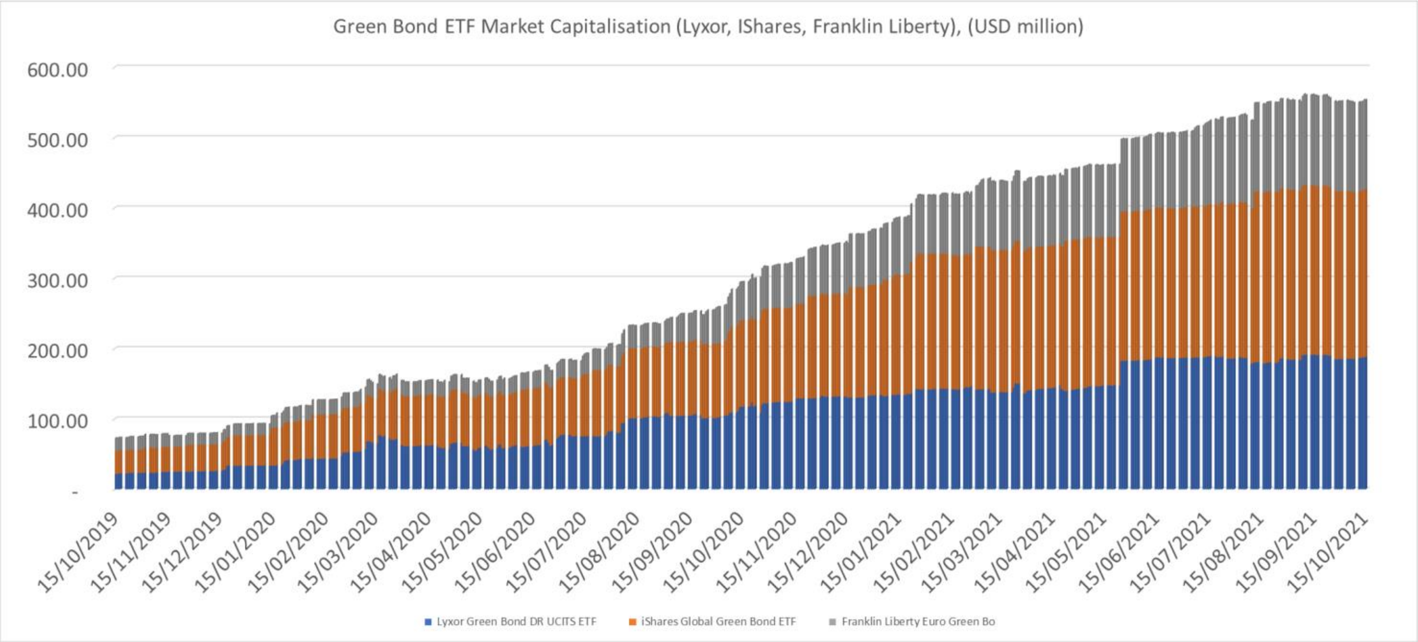
- Premia are calculated using the interpolated swap spread of adjacent or similar non-green issues
- Green Premia values range from -2bp to -8bp
- Given that all Euro RV is extremely sensitive to repo scarcity – and the wealth of funds that ***need*** to buy this stuff – we want to trade from a long – just a slight rarity makes these carry well vs non-Green
- **The recent EU Feb37 looks a great buy**



	OBL Oct-25	DBR Aug-30	IRISH Mar-31	DBR Aug-31	BGB Apr-33	UKT Jul-33	EU Feb-37	FRTR Jun-39	NETHER Jan-40	SPGB Jul-42	FRTR Jun-44	BTPS Apr-45	DBR Aug-50
Current Spread (DM - Asw)	(6.08)	(5.93)	(5.45)	(4.29)	(7.13)	(5.34)	(3.00)	(7.98)	(7.73)	(3.70)	(2.46)	(3.41)	(4.50)
Min (Unadj. spr.)	(6.42)	(6.82)	(8.00)	(4.51)	(7.91)	(6.44)	(2.71)	(7.95)	(7.90)	(4.54)	(2.47)	(4.44)	(4.60)
Max (Unadj. spr.)	(2.78)	(4.29)	(3.40)	(2.98)	(5.90)	(4.74)	(2.29)	(6.52)	(5.74)	(3.11)	(0.33)	2.80	(2.16)

‘Greeniums’

- Taking a look at the Green premium vs fitted curves, and it highlights the following:
  - **Avg premium is -5.2 bp**
  - **EU 37 (new bond),** SPGB 7/42 and FRTR 6/44 - “cheap”
  - Ukt 7/33 neutral as we head into the **green 53s next week**
  - Quite consistent picture. ***-2 bp is the buy level***.
  - All the major ETF providers seem to be launching Green bonds ETFs
    - To the right is the randomly selected Market Cap of 3 Green bond ETFs (Lyxor, Blackrock, Franklin Templeton). Whilst currently small, they certainly exhibit upward growth.
      - Green EGB are naturally a core holding for these funds, and the outstanding size of the Green bond universe is still limited.
      - Strikes me, that as APP purchases slow and ESG space continues to gain traction we should see continued support for Green spreads and dare I say it, they could even trade with a slight short delta bias like low coupons



‘Greeniums’ – Buy EU 37s – steepener vs EU Oct40

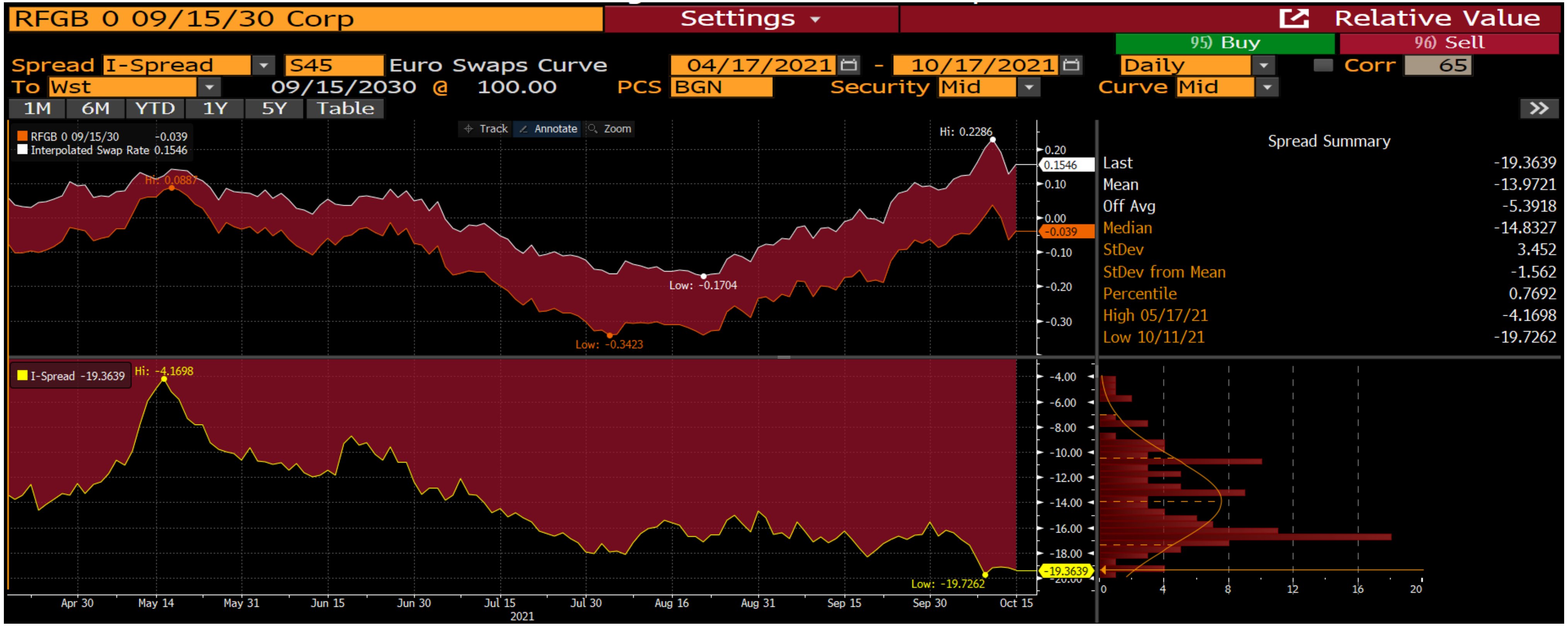
EU swap Spreads – new 37s are close to the boundary condition

- Preferred expression is vs short 40s
- Blend of Jun36 and Oct40 maybe an over-hedge
- Vs other issuers – not quite on boundary condition yet
- **-12.5bp in yield**
- **-6bp vs MMS**
- **Target -9 to -11 bp (vs MMS)**

EU Swap Spreads – recent issues only

Radar Trades

- Sell Finland 29 invoice spreads – 1Bln 10y tap on 20th Oct – small issuance but has performed to the rest in the last 3 months and outperformed other semi-core issuers



Radar Trades

- Take back shorts in Dbr Feb30: -28/+30/-31, 0.4 / 2 / 1.6

- Still short Spain as a credit vs France and Italy

- Long 12y Italy vs 8y and 17y – have that

Radar Trades

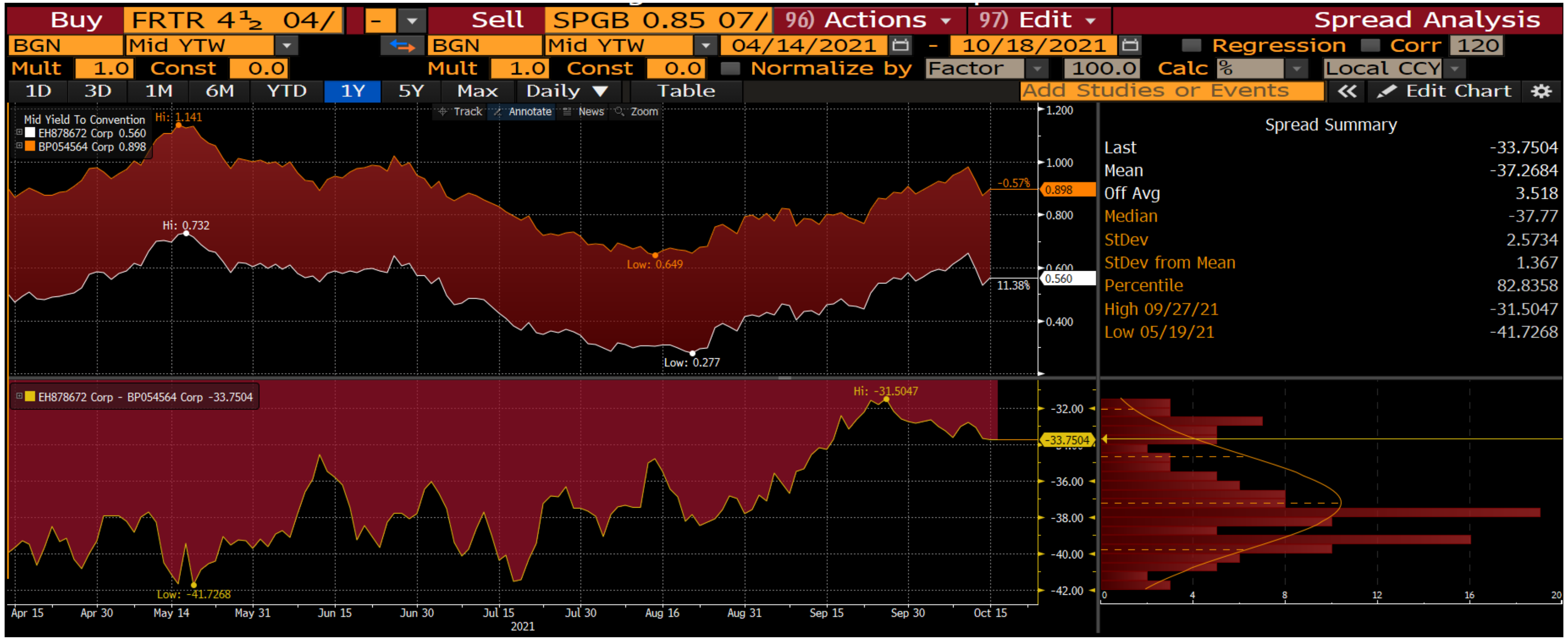
- Short UKT e28 vs r26 & 4q32

- Sell RXZ1 vs Dbr Aug29 and Dbr Aug31

- Short sep30 Finland vs 80% RX and 20% Nether, Finnish supply on 20th

Still running

- -Spgb 37 vs +HC Frtr Apr41
- Got a bit of everything in this – discounted cash-flows, credit, carry, location
- And France – well it's like fear of death or love of life…. I liked buying cos everyone's a seller of France….



Back on: Italy +67s/-72s

- -Btps 72 +Btps 67 Cash weighted vs OIS, default/cash-neutral structuring
- (P2509[BTPS 2.15 03/01/72 Corp] - 0.89 * P2509[BTPS 2.8 03/01/67 Corp])
- P2509 = OIS spread
- The cash weighting allows us to be impervious to the sub par nature of 72s and extract true credit risk
- -0.1bp /3mo Carry even though we shorten up risk in tenor terms = boundary condition

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