



US Rates Alpha

Close 5yT long trade

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In Long 5y outright or through proxies from 3 Nov 23, we recommended clients expressed a long bias in the belly of the UST curve through:

- Outright 5y long, targeting 3.75% on the position with a stop at 4.90%
- 5s30s steepeners with a target of 90bp on the position and a stop at -20bp
- Long 3y1y receiver spreads atm/-50bp (currently +25bp, risk capped to premium).

Rationale for the recommendation

The baseline scenario reflected in these recommendations is one where data recouples to soft landing. In these scenarios we expected the near-term curve bias to be for an outperformance of the belly vs. the wings, driven by: (1) belly forwards recoupling to neutral rate expectations as the market shifts the baseline view from no-landing to softlanding; (2) the potential for neutral rate expectations to reprice lower to c.3-3.25% levels that we believe are more aligned with our economists view and the Fed's own estimates for the neutral.

Closing the outright long 5yT position

The belly of the UST curve rallied c.50bp since we recommended these positions. Yields have recoupled back to macro fundamentals (see Monthly rates models: Dec '23 edition from 7 Dec 23) and risks start to be more balanced at current levels. In our view, the easy part of the rally is mostly done, and a further rally from here likely needs to be supported by a more significant normalization of macro fundamentals. We therefore favor closing the long 5yT position.

Positioning bias from here

Medium term we continue to hold a bullish bias, and the 3y1y receiver spread (which we think makes sense to add at current levels) and 5s30s steepener positions continue to leverage that view. Near-term, however, we see scope for some consolidation and to turn more tactical outright duration.

We also put forth a trade idea discussed in our most recent rates weekly: steeper intermediate part of the SOFR curve (see <u>Doves of a Feather</u>). We recommend positioning for a steeper curve between SOFR Jun '25 & Jun '27 futures. This positions for a Fed that might cut rates faster than the market expects, more deeply below neutral, and find that the US economy rebounds more quickly or sees inflation reaccelerate faster than expected. This could imply a Fed that might need to hike rates again sooner than expected. We recommend entering the M5-M7 steepener at a level of -3bps with a target of 75bps and stop of -40bps. Risk to the trade is a Fed that keeps rates higher for longer and a market that prices a rapid cutting cycle between mid '25 & mid '27.

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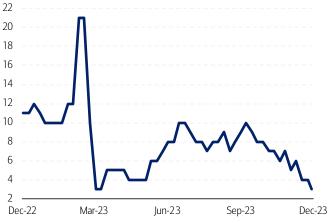
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For a list of our open trades and those closed over the last 12 months, see the **latest Global Rates Weekly**

Exhibit 1: Horizon for the first Fed cut (y-axis in months)

First Fed cut now priced at a 3m horizon



Source: BofA Global Research

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