

Trade idea: Long US 10y via receiver spreads

Trade idea: Long 3m10y receiver spreads

We recommend buying 3m10y receiver spreads to position for a modest decline in 10y rates. We believe that the move may be overdone due to illiquid market conditions (see [here](#) for more details).

Levels

We recommend buying \$50mn of 3m10y receiver spreads struck at ATMF and ATMF-25bp. The strategy costs \$460k. Our stop loss will be equal to the premium paid and our target is \$670k.

Rationale

- The growth data in the US has been disappointing since the start of the year. 1Q GDP is tracking -1% and data for April have not come in particularly strong so far (payrolls, vehicle sales, retail sales).
- Inflation expectations have not moved much during the recent rise in rates and much of this move was felt in real rates.
- The correlation between equities and rates has turned negative, and the equity market has struggled on days when rates have risen. This is probably responsible for the continued inflows in bond funds at the expense of equities. Bond inflows will ultimately provide demand for duration, spread and convexity.
- EM and investment grade spread have been well behaved so far which has prevented duration shedding flows.
- There has been a significant amount of corporate supply but we expect it to decline going into the summer months.
- Much of the rise in rates was driven by the Bund sell-off. We expect Bunds to stabilize as longer dated forwards have become more attractive for LDI flows.
- The Greece situation remains far from being solved and we estimate that they will run out of cash by mid-June. Without a deal, Greece will default either internally (paying IOUs for wages and pensions) or externally to the IMF

Risks

The biggest risks to the trade are a continued rise in Bund yields and position capitulation. CFTC data suggests that asset managers are still in flatteners and the recent steepening of the short dated skew suggests long positioning (see [here](#)). Any price action related to the unwind of these positions can be exacerbated amid thin liquidity.

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