

28 October 2019

Gilt RV round-up

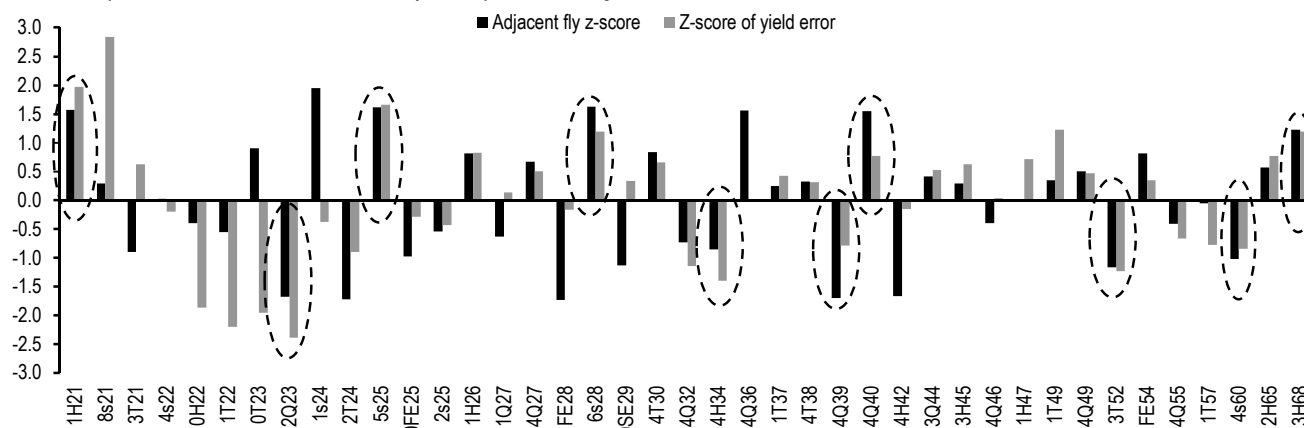
Go long gilt 0FE25 vs. short gilt 2Q23 in SONIA ASW and long the belly of the 0H22/5s25/1H26 level-adjusted gilt fly

This note is an excerpt from [25 October GFIMS](#).

In this excerpt we discuss RV opportunities on the UK gilt curve. In **Exhibit 1**, we highlight bonds that look dislocated on a combination of RV measures. **In the 3-7Y sector**, we highlight the cheapness of gilts 1H21 and 5s25, and richness of gilt 2Q23, although we note that **the 3Y sector as a whole looks rich on our par curve**. **In the 7-15Y sector**, gilt 6s28 looks cheap whereas gilt 4H34 trades on the rich side. **In the 15Y+ sector**, gilts 4Q40 and 3H68 look cheap whereas gilts 3T52 and 4s60 look rich.

Exhibit 1: We highlight gilts that look dislocated on a combination of RV measures

3M Z-score of yield error* and 3M Z-score of the adjacent fly level for UK gilts; unitless

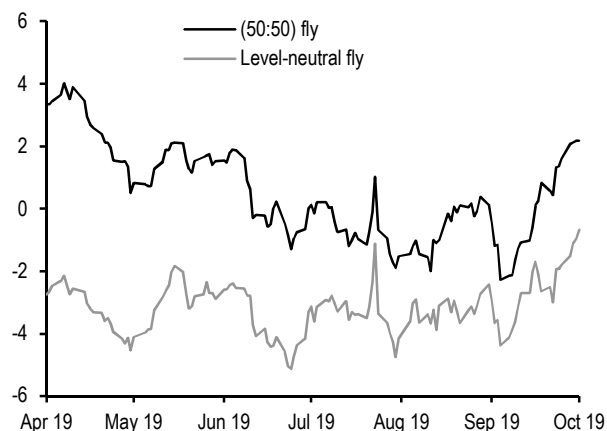


* Based on J.P. Morgan par curve model

For those investors willing to fade the richness of the 3Y sector and cheapness of gilt 5s25, we highlight the belly of the 0H22/5s25/1H26 gilt fly (50:50) is back at its cheapest levels since mid-May. This fly exhibits strong positive directionality vs. the level of yields (6M R-sqr: 72%), and currently looks about 2bp too cheap vs. this driver. Given our neutral duration view **we recommend buying the belly of the 0H22/5s25/1H26 level-adjusted gilt fly which is at cheap levels historically (Exhibit 2, risk weights: -53.5%/100%/-53.5%) with 3M carry and slide 1.2bp.**

Exhibit 2: We recommend buying the belly of the 0H22/5s25/1H26 level-adjusted gilt fly

0H22/5s25/1H26 (-50%/100%/-50%) and level-neutral (-53.5%/100%/-53.5%) gilt flies; past 6M, bp



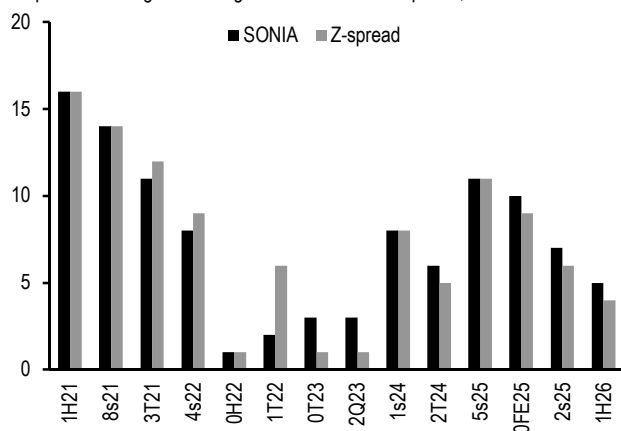
ASW RV

In SONIA ASW space, 2Y+ gilts are at rich levels historically with 5Y gilts around 1.5 standard deviations rich and 15Y+ between 1.7 to 2.5 standard deviations rich on a 3M history. Drilling down in more detail we use our composite ranking to identify RV opportunities in each sector, based on SONIA ASW and z-spreads. This is constructed as follows. **First** we rank the bonds in each sector based on *3M z-score of levels*. **Second**, we rank the bonds in each sector based on *3M change in levels*. **Third**, we then combine these two rankings into a composite rank for both SONIA ASW and z-spread, where a rank of 1 indicates the richest bond in that sector.

Exhibits 3-5 show the results for each maturity sector with 0H22 and 2023 maturity gilts rich and 2025 maturity gilts cheap in the <7Y sector. In the 7-15Y sector 1FE and 4Q32 look rich vs. surrounding bonds whilst in the 15Y+ sector we note various RV dislocations: 4Q36, 1T37, 4Q46 and 1T57 rich and 4Q40, 3Q44, 1T49, 4Q49 and 1FE54 cheap.

Exhibit 3: In ASW space, 0H22 and 2023 gilts are rich with 5s25 and 0FE25 cheap on a relative ranking

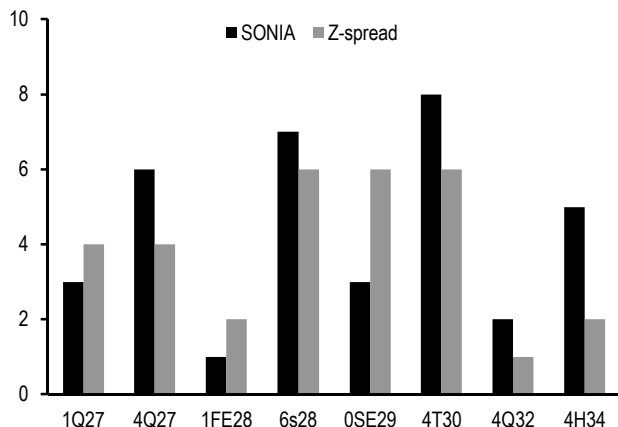
Composite ranking* for <7Y gilt OIS ASW and z-spread, rank 1 = richest bond



* Composite rank is a combined ranking across all gilts in the sector based on two separate metrics

Exhibit 4: Gilts 1FE28 and 4Q32 are rich vs. surrounding bonds

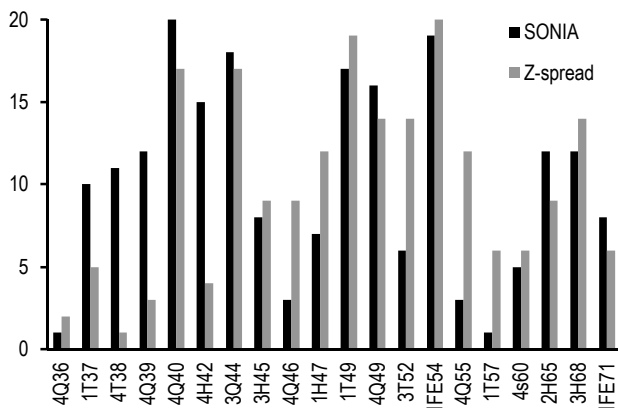
Composite ranking* for 7-15Y gilt OIS ASW and z-spread, rank 1 = richest bond



* Composite rank is a combined ranking across all gilts in the sector based on two separate metrics: 1) 3M z-score, 2) 3M change

Exhibit 5: Our relative ranking measure highlights various RV dislocations in the 15Y+ sector: 4Q36, 1T37, 4Q46 and 1T57 rich and 4Q40, 3Q44, 1T49, 4Q49 and 1FE54 cheap

Composite ranking* for 15Y+ gilt OIS ASW and z-spread, rank 1 = richest bond



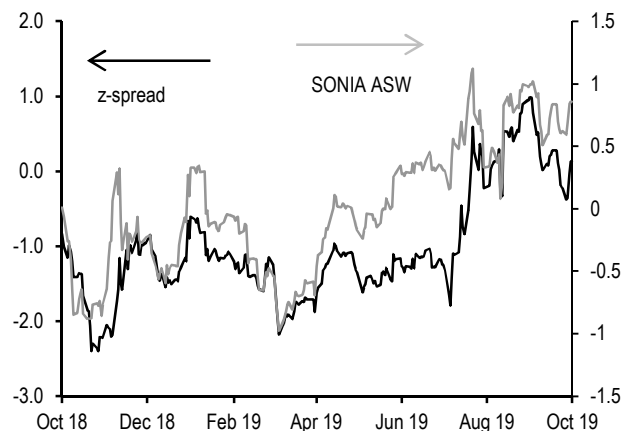
* Composite rank is a combined ranking across all gilts in the sector based on two separate

Overall, we highlight:

1. **We recommend buying 0FE25 vs. 2Q23 on a SONIA ASW basis.** 0FE25 has underperformed following recent supply and offers a 5bp pick-up over 2Q23 win SONIA ASW space, with the relative SONIA ASW spread is at its widest levels since late August. 0FE25 will be tapped again on 26 November but we expect this bond to outperform vs. surrounding lines as it is built up to benchmark size
2. **Buying 1T49 vs. 4Q46 on a SONIA ASW basis looks attractive.** 1T49 offers the highest SONIA ASW pickup across the gilt curve (around 45.5bp) and looks cheap vs. 4Q46 on SONIA ASW basis, with the relative spread close to its widest level for the past 12M (**Exhibit 6**). 1T49 is tapped in mid-November but we think current relative levels already reflect a supply concession

Exhibit 6: Buying 1T49 vs. 4Q46 on a SONIA ASW looks attractive

4Q46/1T49 relative z-spread and SONIA ASW; past 12M; bp



Trade recommendations¹

High-conviction trades are starred (★). All other recommendations are moderate-conviction

New trades:

- **Go long gilt 0FE25 vs. short gilt 2Q23 in SONIA ASW**
 - Current level: 4.2bp (relative ASW level). 3M carry and slide is -0.9bp.
- **Go long the belly of the 0H22/5s25/1H26 level-adjusted gilt fly**
 - Go long 100% risk in gilt 5s25 vs. short 53.5% risk in both gilts 0H22 and 1H26 @ -0.9bp (weighted spread). 3M carry and slide is +1.2bp.

Existing trades:

- **Stay long gilt 1T37 vs. short gilt 4Q36 on a SONIA ASW basis**
 - Current level: 8.1bp. 3M carry and slide is -0.3bp. P&L since inception is -1.2bp (recommended 3 May).

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¹ All trades priced as at 25 October 1pm. See the latest *GFIMS* for full trade recommendations.

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