

Extreme carry in EUR CMS spread caps

Further trades from our scan over 7,500 EUR and USD CMS spread caps

Trade Ideas

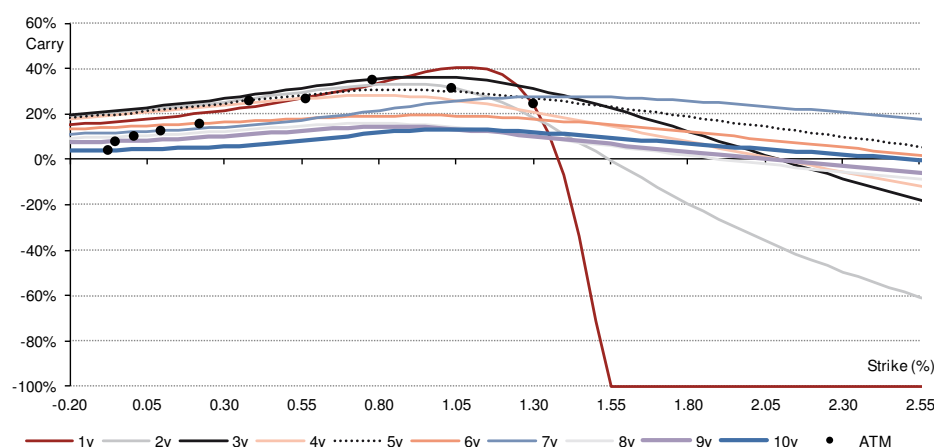
1. 1y expiry 10s30s EUR SL CMS cap spread 0.40-0.70 for 15.75cts, giving a 1y carry of 97% of the premium. Breakeven: 0.55%. CMS adjusted forward: 0.53%. Spot: 0.68%.
2. 1y expiry 5s30s EUR SL CMS cap spread 1.10-1.50 for 22.5cts, giving a 1y carry of 95% of the premium. Breakeven: 1.33%. CMS adjusted forward: 1.33%. Spot: 1.53%.

Reference levels: adjusted 1y forwards 10s30s: 0.53, 5s30s: 1.33%.

In our recent report, [Finding extreme carry in CMS spread caps](#), we argue that trades in CMS spread caps offer high, even extreme, carry. In particular, we scanned over 7,500 trades in EUR and USD, for five CMS spread combinations (5s30s, 2s30s, etc.), with expiries up to 10 years, and over 50 strikes, with the aim of maximising carry. We selected some trades in USD CMS cap spreads, in 5s30s and 5s10s, as the most attractive in carry terms.

In this report, we turn our attention to CMS spread caps in EUR, some of which offer high carry too. We focus on what we consider the two most promising slopes: EUR 10s30s, and 5s30s, for caps with one-year expiry.

Fig. 1: EUR 5s30s CMS spread cap, single-look. 1-year carry (as % of premium) vs strike, for different option expiries



Source: Nomura Research

The usual results for carry in Figure 1 do not appear too attractive at first glance. However, we can substantially improve the carry by trading a spread of CMS spread caps – i.e., buy and sell the caps at different strikes. Our optimisation over the strikes shows that, for these two slopes (EUR 5s30s and 10s30s), we can obtain better carry by buying the cap vs selling another cap with a higher strike.

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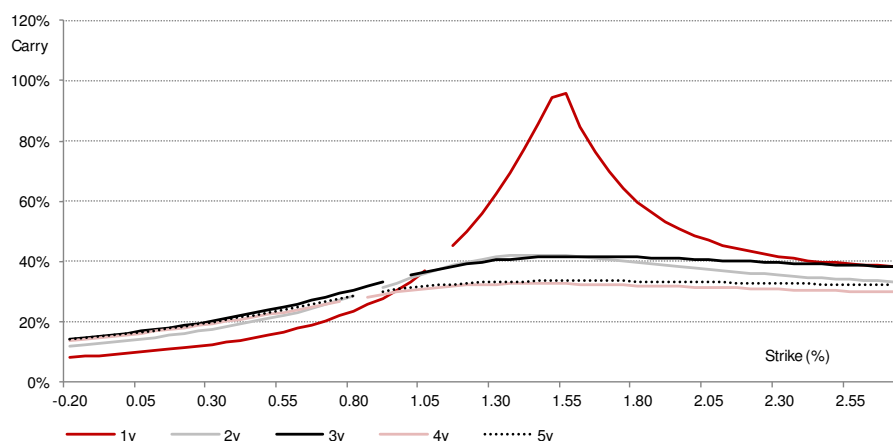
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Fig. 2: 1-year carry from buying an EUR 5s30s CMS spread cap (single-look) struck at the highest carry point vs selling another cap (strike in horizontal axis)



Source: Nomura Research

In Figure 2 we can see that for the 1y expiry 5s30s CMS caps, we can reach a 1-year carry of 95% by buying the cap with the highest carry (1.10 strike) and selling a cap struck higher, at 1.55. The breakeven point is at 1.33% or 20bp below the current slope.

In the same manner, for the 10s30s CMS cap, we can obtain a 1-year carry of 97% by buying a cap at 0.40 and selling a cap struck at 0.70. The breakeven point is at 0.55% or 13bp below the current slope.

Risks

For completeness, we present the risks to the trade. The vega risk, which is a combination of the simple (i.e., Black-Scholes style) vega of the option on the spread and the delta of the option multiplied by the sensitivity of adjusted forwards to volatility, is positive for both. Meanwhile, the negative decay (theta) is not large.

Fig. 3: Trades and risks

Trades - €100mm notional per leg		Strike	ATMF	Spot	B/E	Premium (€)	Horizon	Carry	Theta (€/day)	Delta (€/bp)	Vega (€/bp)	Correl Risk (€/%)
EUR 10s30s	1y CMS Spr Cap Spr SL	0.40-0.70	0.53	0.68	0.55	157.5k	1y	97%	-33	-27	556	-263
EUR 5s30s	1y CMS Spr Cap Spr SL	1.10-1.55	1.33	1.53	1.33	225k	1y	95%	-30	-65	551	58

Source: Nomura Research

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Appendix A-1

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