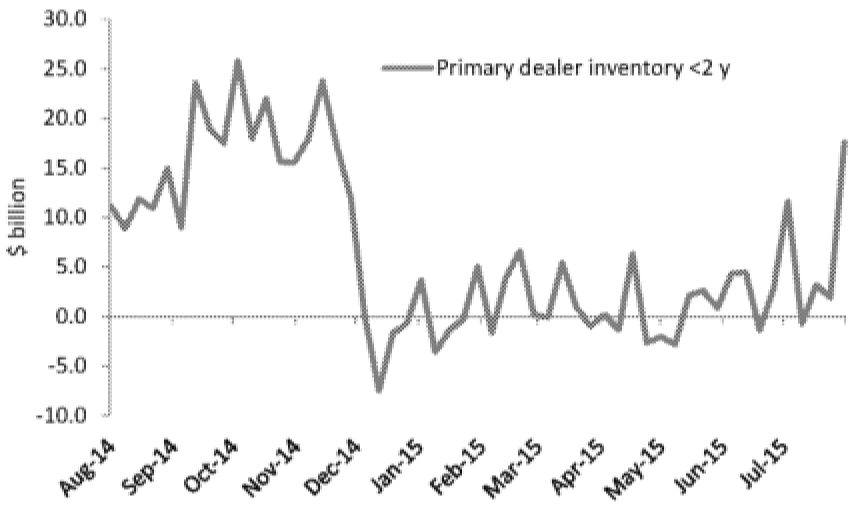
September 2017 5y note, which means the large issue is unlikely to trade tighter than GC. We note that as usual this September 2y should be the CTD issue into the December TU contract.

In fact 3m GC has traded at levels above LIBOR as financing markets price defensively for the possibility of a September rate hike. This would effectively mean borrowing to fund the position at higher rates than offered by the Treasury asset itself. In this case investors are likely better served by rolling on open rather than locking in term financing. September month/quarter end could see elevated overnight GC levels, which would argue for exiting the trade at or shortly following the FOMC meeting. Naturally the trade is exposed to further spread tightening, and in theory potential losses are unlimited. However, more pragmatically, financing spreads offer some support against dramatic spread tightening.

Dealer positions in Treasuries maturing in 2 years or less



Source: Federal Reserve and Deutsche Bank

Did dealer positions tell much about intervention flows in the past?

The concentration of foreign official holdings of Treasuries in the front end of yield curve suggests foreign reserve losses lead to yield curve flatteners to the extent that central banks sell their Treasury holdings. Treasury's TIC data shows that about 56% foreign official holdings of Treasuries mature within three years as of June 2014, up from about 48% as of June 2010.

We note that primary dealer positions in short dated coupon Treasuries and TIPS have increased rapidly over the past few weeks. For example, dealer positions in Treasuries maturing in three years and less jumped to $18.6 billion on August 26; they were as low as -$11 billion in early July. Dealer positions in short dated TIPS set a record high on August 19.