



There are some quiet bear trades that we continue to like. More volatility in the front end than back end; accumulator trades that put you into deferred payers conditional on short rates underperforming their forwards. We also still like cheap risk on protection trades that knock out if rates do breach their forwards.

There are lots of issues that will likely roil markets. Greece is unresolved. The US jobs data has been so strong that it could lose a beat. The Fed is entering a decision zone that could rattle risk markets if too aggressive or the back end if too much of a "relent". With falling reserves and the end of bank HQLA purchases, investors are wondering who are the new buyers – especially as fx reserves are now falling, partly China but also petrodollars. Domestic insurance/pensions for now perhaps and maybe Japan again after their year end? While in Europe bonds are hard to come by and the ECB has only just begun!

All said and done though 2 percent 10s seem a very good mid point around which to trade with 5y5y around 2 ½ percent. Daily realized volatility has been as high as 15 bps compared with more like 5 bps last year. So whatever the conviction, make it less so!

Term Structure

There has been just one day this year when being short the five year rate made money versus the 3 month forward. So for all the focus on "being in flatteners", it is important to appreciate that flatteners have worked to the extent that the long leg has rallied. Pushing the Fed up till now has been a fool's game. Over the past twelve months it is not much better with 5s beating the forward as around 10 percent of the time and that was concentrated in September before the Fed meeting. Note that the forward on March 6th was exceeded by 2.8 bps. It is hard not to take the moral of the story as not to push the Fed and that was before the latest FOMC meeting.

Of course the curve is actually not flattening this year. 5s10s has been impressively stable around 45/50bps. If you can't make money from shorting the front end leg and the curve is stable, by definition this year is being defined by a range and performance is dictated by identifying the limits of that range. The range itself is anchored around a 2 ½ percent 5y5y rate in our view which is consistent with our original outlook for 2015. If 5s gravitate towards their forwards (but not exceeding them!), 10s can budge a little higher to say 2 ¼ percent for a 2 1/2 percent 5y5y rate. 5y5y has already traded close to 2 ¼ and back up towards 3 percent as 10s came close to 1 ½ percent and traded in swaps over 2 ¼ percent. We think what we have seen so far this year remains a good template for trading through q2 and into the second half. Our view remains that we are likely to finish the year when 10s around current levels and 5s still no exceeding their forwards.