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Subject: 10 year swap spread
Date: Mon, 22 Nov 2010 14:58:58 +0000
Inline-Images: image003.jpg

Swap Spread Idea: (Target entry at +9bps; currently at +15bps; target exit at +25bps)

Currently the spread between the 10 year treasury (2.81%) and the 10 year swap (2.96%) is 15 BPs. This spread has widened from a historic low -5 BPs in early September. As shown in the 5 year chart below, spreads historically run around 40 BP. If we go back further, the chart tells the same story.

With announced QE2, the economics of the 10 year treasury lead us to believe yields will likely remain capped while the swap market (represents the investor community) will be driven by economic data. If the Q4 consumer spending and profits numbers surprise to the upside, swaps would likely move higher relative to Treasury yields.

To achieve this exposure we buy the 10 year treasury and pay fixed on a 10 year treasury swap. We would match the DVO1s making us hedged for equal shifts in UST vs swaps. You would borrow 95% of the Treasury cost at Libor + 75bps.