## Treasury Roll Spreads Are At Fair Value (within the bid/ask) John Coleman | August 2018



Some 'generally reputable' shops have been sending out warnings on Rich/Cheap roll levels—as if some money manager with a couple billion is going to blow the roll market apart. (Bloomberg story refs):

JP here: {NSN PDK7QI6JTSE8 <GO>}
RBC here: {NSN PDLVPY6S9729 <GO>}
DB here: {NSN PDM1816KLVRG <GO>}
MS here: {NSN PDM4GM6JIJUQ <GO>}
Bar here: {NSN PDIAEJ6VDKHW <GO>}

When research folks venture into the zone where traders used to comment, things get a bit long on stories and a bit short on arbitrage math. If nothing else, in all rolls with the exception of the 'old Bond future' (USU/Z), the DEC future has a calculably-larger DV'01 than the SEP future. That means when traded 1:1 on a roll spread, what you do to the DEC contract determines whether you are long the market or short the market. If you get the market direction right, you'll get the spread right. Of course, if you can do that, you will be retired before the Treasury Futures Roll completes.

The roll levels are quantifiable and arbitrage-able. With Citadel streaming tight markets in off-the-run Treasuries (i.e. those that are frequently cheapest to deliver), AND with visible/trade-able synthetic Treasury-term-repo (via ICE Treasury Repo futures), there isn't a lot of guesswork anymore. Why do I think 'reputable shops' would put out STORIES about, "The Roll Is Rich (Cheap)!"? I don't know, but when I look at some of the drivel above, it makes me think impure thoughts.

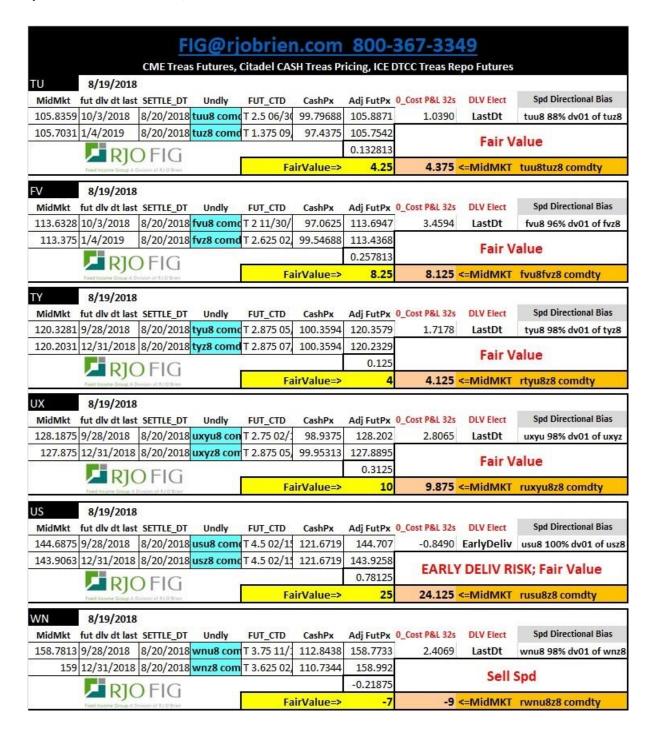
Early delivery risk is absolutely possible; though not probable as of now. For TU, FV, USY, TY, UXY, US and WN, Friday 8/31 is FIRST NOTICE DAY (i.e. when the love note comes from the Exchange notifying an early-delivery recipient that they need to come up with CASH, and they'll get "what's in the box" on Sep 4—first Delivery date). USU8 is a possible early delivery (Sep basis carrying about -1/32s to last delivery date). ALL OF THIS WILL CHANGE BEFORE FIRST NOTICE DAY. The bottom line is this:

LONGs in Treasury Futures really should be rolled from Sep18 to Dec18 before 8/30/18—unless you want to take delivery (If so, call us so we don't get 'the shocker' from the CME).

As touched upon above, there are (virtually) always, disparities in dv'01 (and convexity) for Treasury Futures from one quarter to another—and depending on the deliverable in Sep versus in Dec, sometimes there may be a small/subtle yield curve trade in a Roll Spread. Mostly, it's directional bias:

8/17/2018 ContSize	Treas Future	DV	01/cont	•	1,000 Rolls U-1Z) Has Δ	Owning 1,000X ROLL Leaves
200k	TUU8 Comdty	\$	38.27	\$	(5,200.61)	Short the equiv of -136 TUU8
200k	TUZ8 Comdty	\$	43.47			
100k	FVU8 Comdty	\$	46.18	\$	(1,978.41)	Short the equiv of -43 FVU8
100k	FVZ8 Comdty	\$	48.15			
100k	TYU8 Comdty	\$	73.72	\$	(1,633.81)	Short the equiv of -22 TYU8
100k	TYZ8 Comdty	\$	75.35			
100k	UXYU8 Comdty	\$	106.24	\$	(1,853.78)	Short the equiv of -17 UXYU8
100k	UXYZ8 Comdty	\$	108.10			
100k	USU8 Comdty	\$	183.24	\$	304.86	Long the equiv of 2 USU8
100k	USZ8 Comdty	\$	182.94			
100k	WNU8 Comdty	\$	267.29	\$	(4,592.11)	Short the equiv
100k	WNZ8 Comdty	\$	271.88			of -17 WNU8

Based upon Friday's settlement marks, here are the arb levels for the TREASURY ROLLS. Call our desk any time to check real-time, mid-market levels:



One last comment to our friends on the mortgage side especially: Treasury Futures are NOT like TBA rolls. With TBAs, the roll is 'the drop'. Meaning, a monthly TBA roll of 5/32s infers that the more-distant month will 'go up' by ~5/32s over the ensuing month. Treasury Futures Rolls do not 'equate to carry'. Cash CTD spot and forward prices, futures conversion factors, difference in cheapest to deliver securities ALL impact the roll spread—calculable, but NOT indicative of carry like TBA rolls. JC