Fixed Income Group A Division of RJ O'Brien

# New SOFR Futures Have Over-Inverted Relative to 2-year Treasury

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As is often the case with new instruments—especially derivatives—pricing can get wonky due to relatively small directional flows pushing relationships out of whack.

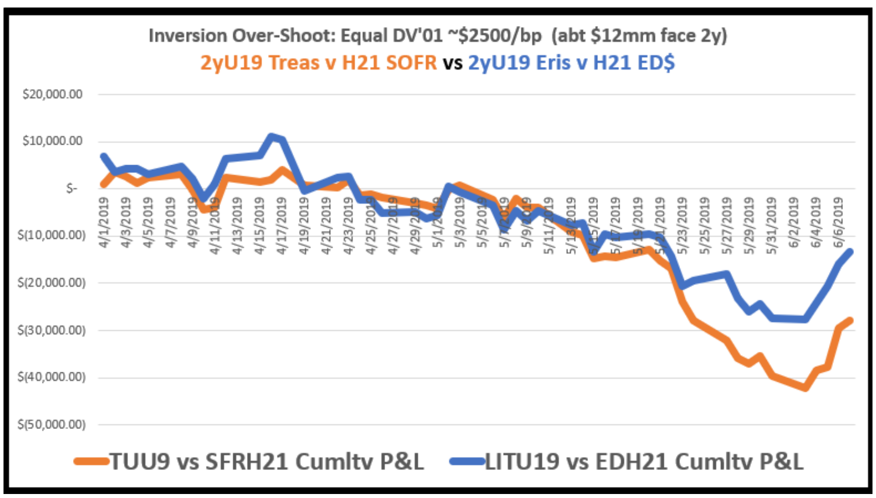
Back-month SOFR futures, specifically SFRH1 (Mar'21 3mo SOFR on CME), have outperformed September'19 2-year futures (TUU9). The overshoot in the relationship peaked last Monday (6/3)—along with the peak of inversion on the front-end of the yield curve.

I am speaking my position here: I like owning the curve from the nose to Sep'20, then dv'01-neural shorts from Mar'21 thru Mar'22.

Many of the trades we can implement in ED$ futures are not do-able in SOFR; yet. But there is activity and open interest out to Jun'21 in 3mo SOFR futures.

What's so great about buying 2yrT-futs? Why not just put on SOFR:SOFR or ED$:ED$ spreads?

It's RARE when a CONVEX instrument can be bought, and a NON-CONVEX instrument can be sold, without significant negative carry. After all, the cost of carry should be equal to the option value of convexity. TYPICALLY, LONG OPTIONS HAVE AN UPFRONT COST AND DECAY. Buying 2yr Treasury (convex) and shorting SOFR futures (non-convex), gets you the long option/convexity. The same trade may be made using ERIS 2yr vs ED$s. The peak of the curve inversion should defray most/all negative carry. Here's how the Treasury/SOFR & SwapFut/ED$ curve has moved:




LITU19 Eris 2y Swap Futures at 1.82% vs. EDH1 at 1.665% → Inverted 15.5 bps
TUU9 CTD YTM at Delivery 1.69% vs SFRH1 at 1.445% → Inverted 24.5 bps

So, I think SEP'21 SOFR is rich to TUU9 by at least 5bps and perhaps as much as the full 9bps.

JC

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