

## US Rate Strategy Notes

### Alert: Shorting 5y breakevens

Last week, we closed our long position in 5y breakevens that we had initiated in December. ([Close long 5y BE trade](#)). Yesterday, we also closed our long position in front end TIPS ([Close long 2y TIPS hedged with short 10y breakevens](#)). While we like the front end of the breakeven curve from a medium term standpoint, current levels in the 5y appear likely to act as a ceiling in the very near term. Given that CPI and PCE are currently running south of 2% (1.7% and 1.3% respectively), we don't see much more upside yet with 5y breakevens at 2.35%. While our longer term view on breakevens is positive, we expect the move wider to be more gradual than the recent pace of widening. Note that shorting 5y breakevens is also a cheap way to position for a potential fall in risk appetite, with positive carry (8bp of positive carry to Feb 28, 2013).

The main risk to our view in the near term is supply - more precisely, the lack of it in the 5y sector. The next 5y auction is in April. We do have 30y supply in February and 10y supply in March. The lack of near term supply in the 5y sector could create a tailwind for 5y breakevens. Dealer inventories in TIPS are running low, at 1.5bn, compared to an average of about 2.8bn over the last three years (using Federal Reserve data on primary dealer positions). However, dealer positions did get lower in early 2011 (-2bn in March to April 2011) during a similar run up in breakevens.

We enter half our risk (100 MM of the April 17s) at 2.345%, with a beta of 0.55 to the nominal 0.875% of April 17s. We plan to add to the position if there is any strength in breakevens in the next few sessions.

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