

## US Rates Trade Recommendation

### Long Duration in the Front-End of the Curve

- **We Recommend Long 3yr Treasuries** — With Treasury yields near the high end of the one-year range we recommend a long duration position. Since we ultimately expect yields to break out of the high end of the range we would keep the risk level low.
- **No "Premature Tightening"** — The 'dovish' phrase noted from Bernanke's testimony today was his concern that "premature tightening" could threaten the recovery. We would also note that NY Fed President Dudley opined today that fewer purchases (tapering) adds less stimulus – it does not reduce stimulus in his view. Combining these views suggests to us a combination of tapering and stronger extended guidance on Fed Funds. We see this as a significant risk to long maturities and a modest risk to short maturities.

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## Long Duration in the Front-End of the Curve

We recommend a long duration position in 3yr Treasuries to take advantage of yields that are near the high-end of the 1yr range. Since we ultimately expect Treasury yields to move out of the high end of the range we will keep the level of risk low. We favor the front-end of the curve as we see far more risk to the long-end as tapering of QE purchases becomes more likely.

Figure 1. Trade Recommendation:

Trade Details	Start Level	Rec. Date	Trade Horizon	DV01	Target Profit	Target P/L	Stop
Buy \$450 mil 3yr Treasuries (T 0.25% 5/16)	0.411	5/22/13	3-months	909	10bp	\$1.3 mil	5bp

Source: Citi Investment Research and Analysis

To clarify the “low risk” sizing of our recommendation we emphasize that we are accounting for this in two steps. Let’s assume that we considered a low level of risk for our portfolio to be \$50 million 10yr Treasuries.

- **DV01 Adjusted** – Since the DV01 of a 3yr is about one-third of a 10yr, \$150 million 3yr Treasuries would be a low level of risk.
- **Beta Adjusted** – Since the 3yr has about one-third the volatility of the 10yr, we would consider 3x the DV01 in the 3yr relative to the 10yr to be empirically risk neutral. Therefore, \$450 million 3yr vs. \$50 million 10yr.

This trade recommendation follows from the views we discussed in more detail in a [May 10 article](#) and, hopefully, takes advantage of a more favorable entry point.

## Appendix A-1

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