

## Developed Market Rates

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# Euro Rates Strategy Update

## Bund Curvature: Buy 10yr versus 5yr and 30yr

- We recommend buying 10yr Bunds versus 5yr and 30yr.
- There has been significant convergence among global yield curves recently; it is just the 10s30s sector in Bunds that is lagging.
- The 5yr sector might look superficially rich, but we argue that it is really the 10yr sector that is cheap.
- The -5yr+10yr-30yr butterfly has much better carry and roll than the +2yr-5yr+10yr alternative.

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**Figure 1. Bund -5yr+10yr-30yr Butterfly (Percent)**



Source: Citi Investment Research and Analysis

**See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.**

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# Euro Rates Strategy Update

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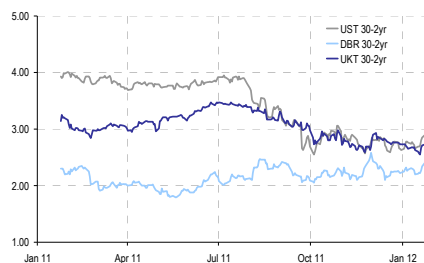
**We believe that the 10yr sector of the Bund curve is cheap, rather than the 5yr rich**

## Bund Curvature: Buy 10yr versus 5yr and 30yr

There has been significant convergence among yield curves over the past year (Figure 2). The Bund curve remains slightly flatter than the UST and UKT curves, although this is perhaps unsurprising given the ECB's reluctance to start cutting rates until as recently as November last year.

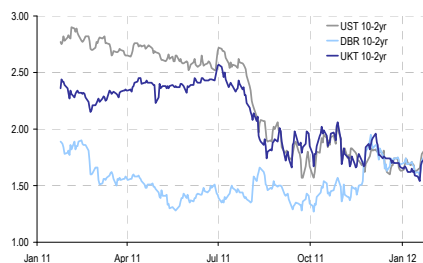
A closer look shows, however, that 2s10s spreads have converged across all three markets (Figure 3); it is only the long end of the curve where Bunds remain an outlier (Figure 4). The effect of this is that while the 5yr sector may look rich in a 2s5s10s butterfly, the front end of the curve is in fact consistent with the broader slope. In our view it is the 10yr sector of the Bund curve which is cheap rather than the 5yr that is rich.

Figure 2. 30yr-2yr Yield Curve Spreads



Source: Citi Investment Research and Analysis

Figure 3. 10yr-2yr Yield Curve Spreads



Source: Citi Investment Research and Analysis

Figure 4. 30yr-10yr Yield Curve Spreads



Source: Citi Investment Research and Analysis

**5s10s30s butterfly has significantly further to move than 2s5s10s and has much better carry**

We see the risks in the 5s10s sector as asymmetric compared to the more directional 2s5s and 10s30s spreads; higher yields would likely see a bearish steepening of 2s5s relative to 5s10s, while a fall in yields will likely see the 5yr underperform the 10yr as bull flattening extends through the longer sectors. This is the mechanism through which curvature should eventually decline.

Taking Japan in the 2002-07 ZIRP/Rinban period as a template for how low convexity premia can potentially go (Figure 5), we can see that curvature in the front-end (2s5s10s) of the major curves appears to have fully converged. It is just the long end (5s10s30s) curvature in Bunds that looks too high. Moreover, the 5s10s30s butterfly has much better carry than 2s5s10s.

Figure 5. Comparing Yield Curves with Japan 2002-07

	2yr	5yr	10yr	30yr	2s10s	10s30s	2-5-10	5-10-30
Japan 2002-07 Average	0.23	0.66	1.38	2.21	1.15	0.83	-0.15	-0.06
UST	0.24	0.91	2.07	3.15	1.82	1.09	-0.24	0.03
DBR	0.21	0.94	1.98	2.64	1.77	0.66	-0.16	0.20
UKT	0.42	1.13	2.15	3.13	1.74	0.97	-0.16	0.03

Source: Citi Investment Research and Analysis

## Trade

Buy 1.0 units 10yr Bund at 2.00%  
Sell 0.5 units 5yr Bobl at 0.95%  
Sell 0.5 units 30yr Bund at 2.64%

Entry spread +20.5bp. Target 0.0bp. Stop-loss +30.5bp

## Appendix A-1

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