ERIS EXCHANGE

Q1 Swap Spreads: Will the Cycle Break from the Norm in 2017?

The first quarter of the year is typically a crucial period for US investment-grade debt issuance, and this can have an impact on swap spreads. Swap spreads represent the difference between the rate on an interest rate swap and the yield of a US Treasury with a similar tenor.

This dynamic can be observed with the Bloomberg seasonal graphing tool ({SEAG <GO>}). The following heat map was created using this functionality and illustrates the monthly changes in 5-Year headline swap spreads in Q1 for the past 7 years; spreads tend to tighten in February and March, after widening in January.

Spreads have typically tightened in February and March, after initial widening in January.

Q1 Swap Spread Cycle:

USSP5 CMPN Curr | 95) View | 96) Edit
Last Price | Spread
7 Years Ending 2016 | Percent Cha
Calendar Year | Trailing 12M | 01-Jan - 31-Mar

	Jan	Feb	Mar	Apr
Average (Monthly Change)	1.68	-2.07	-1.00	
2016	-1.00	-3.88	4.50	
2015	5.62	-2.50	1.00	
2014	6.81	-1.81	-1.44	
2013	3.22	1.03	2.87	
2012	-11.44	-3.00	-1.81	
2011	6.56	-2.56	-.88	
2010	2.00	-1.75	-11.25	

SOURCE: Bloomberg

What Causes This Pattern?

Into year end, corporations typically enter a quiet period, focusing their attention on preparing for the new year. After releasing earnings in January, corporate treasurers usually commence their debt issuance. Banks in particular, often transform these fixed-rate obligations into floating using interest rate swaps. To do so, they receive fixed on the hedges, putting downward pressure on swap rates causing spreads to narrow.

Learn More About Swap Spread Trading Using Eris: [Swap Spread Trading]

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Call (888) 587-2699 option 2 or
sales@erisfutures.com

Will This Repeat Again in 2017?

History can never be the sole guide to future performance. However, the pattern of corporate issuance and the consequent need to receive fixed on swaps is already starting to take place in 2017. But dollar funding pressures in money markets and a host of other macro factors should also be taken into consideration.

How Can You Trade This?

Swap spreads can be traded using OTC swaps and cash Treasuries, but traders can also use Eris Swap Futures and CME Group UST Futures. The futures strategy benefits from substantial margin savings, and is tradable anonymously in a liquid and transparent marketplace.

For example: To put on a spread tightener, traders can sell Eris Standards (receiving fixed on the swap leg) and sell US Treasury Futures (shorting Treasuries) in equivalent duration to effectively receive the spread. The chart below shows how the yield spread between the March Eris 5Y contract and the March 5Y UST Future tracks the yield spread between spot US 5Y swaps and March 5Y UST Futures.

The yield spread between the March Eris 5Y and the March 5Y UST Future tracks the yield spread between spot US 5Y swaps and Mar 5Y UST Futures.

SOURCE: Bloomberg

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