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Since 1950

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Instant Thoughts

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Nowhere to Hide

- **The tech sector been an outperforming sector and software is up since late February. The sentiment factor matters too.**
- **The bond selloff resulting from a steepener unwind is coming to its end. It curbs realized volatility and by extension, the directional option-driven flows.**
- **If the subsequent risk of a missed coupon recedes, the return of debt redemption flow will also keep short-dated rate contained.**
- **The spirit of this era is more TACOist than revolutionary. It's better to own rate when the vultures are still circling.**

"The gods love what is secret and abhor what is obvious." Italian writer Roberto Calasso's observation resonates with us. If you had told us that rates would confront another egregious episode of demand destruction caused by the energy crisis, alongside a negative payrolls report, we certainly would have assumed the damage to U.S. 2-year note would have been less than 50bps.

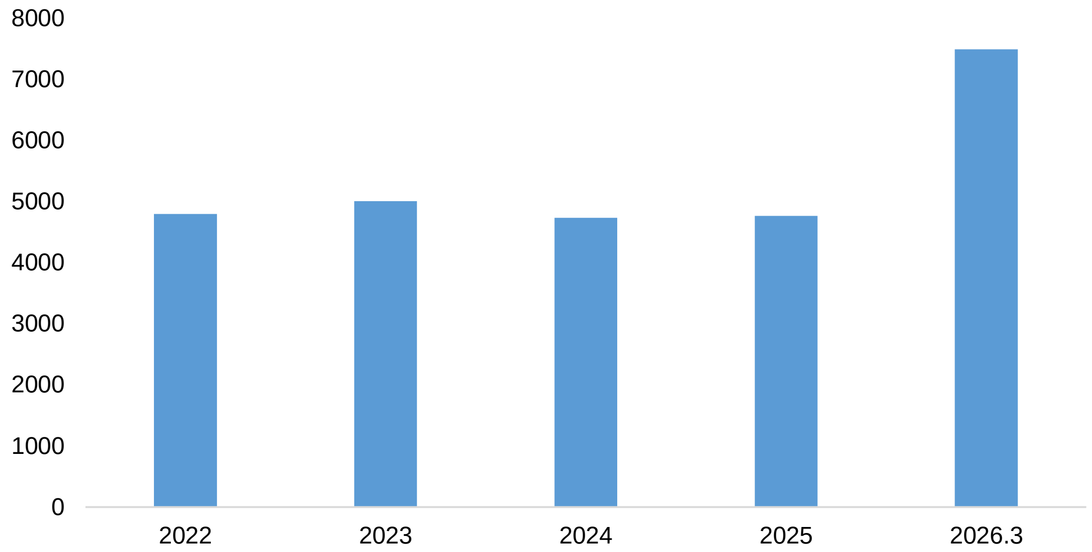
The war overseas has hit home. Is the ratchet higher in rate an irresistible trend? Be skeptical. As so often, a period of panic engenders its opposite.

Notice that tech was typically one of the eyesore sectors. In the current episode, it's been an outperforming sector, and software is up since late February. We're not saying shareholders are more prescient than bond managers, but the sentiment factor matters too.

The imminent end of cage fight between steepener and flattener is another thing. Since the onset of the Iran conflict, the unwind of steepeners provided a steady offer to the short end, keeping realized volatility elevated. Now the positioning washout fizzles out, curbed realized volatility and the concomitant decline of the forced selloff will follow.

Of course, we are all at the mercy of liquidity change. Recall that a horde of callable buyers is lulled out of the woodwork by the yield enhancement. The callable bond market, originated from their sale of optionality to issuers and concentrating around 1-5 year maturities, reaches US$7,500 billion of late. If dust starts to settle and the subsequent risk of a missed coupon recedes, the return of debt redemption flow will keep the short-dated rate contained.

Exhibit 1: Outstanding Amount of U.S. Callable Bond (US$ bn)



Source: Bloomberg, Shanghai Commercial Bank

Faced with information overload, the fear of making the wrong call can be paralyzing. For now, traders may prioritize recency over accuracy. The spirit of this era is, however, more TACOist than revolutionary. When wars can be trivialized, so does the perceived need for protection. It's better to own rates when the vultures are still circling.

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