

Gilt Relative Value

(Succeeding the 'Gilt Anomalies' series)

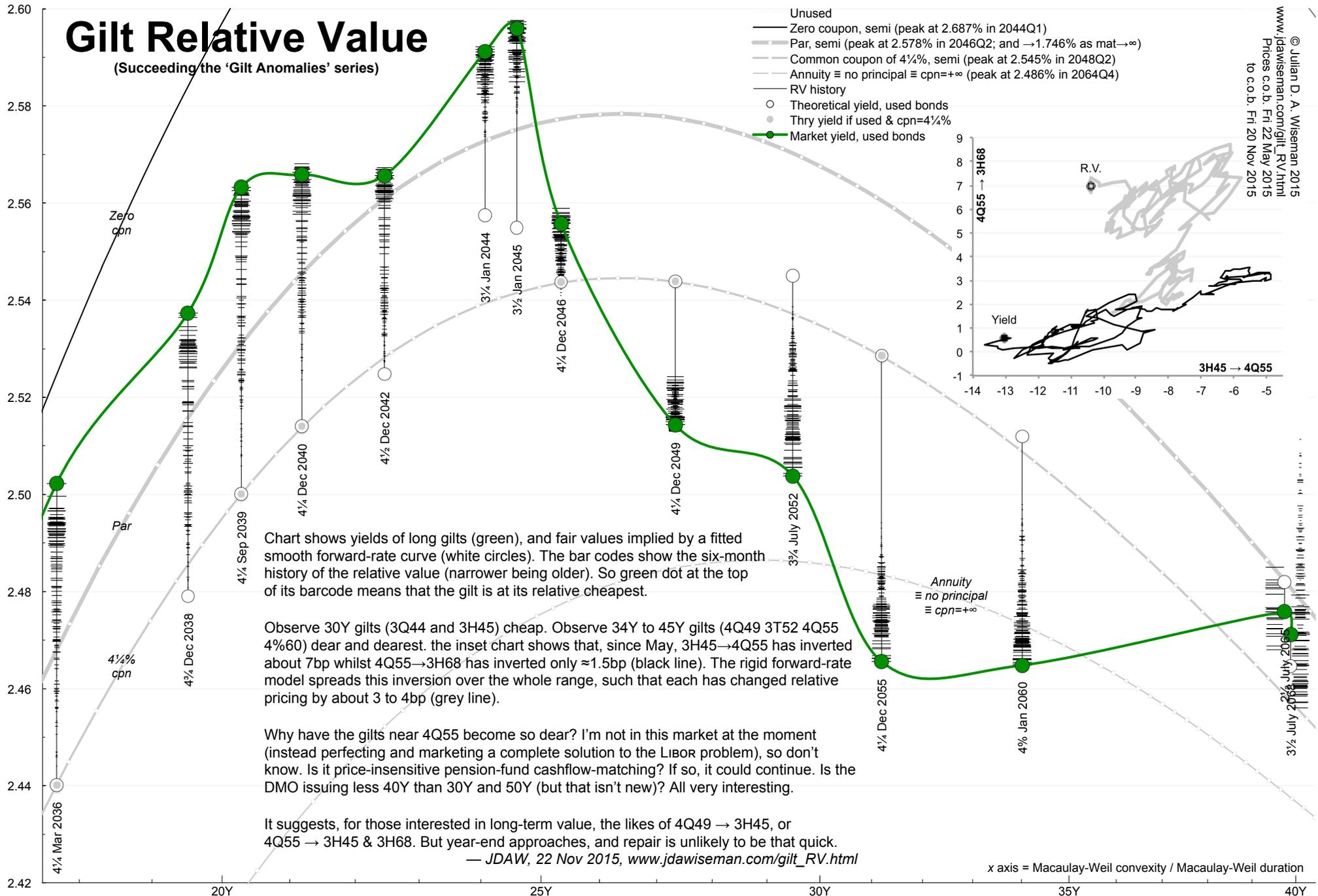


Chart shows yields of long gilts (green), and fair values implied by a fitted smooth forward-rate curve (white circles). The bar codes show the six-month history of the relative value (narrower being older). So green dot at the top of its barcode means that the gilt is at its relative cheapest.

Observe 30Y gilts (3Q44 and 3H45) cheap. Observe 34Y to 45Y gilts (4Q49 3T52 4Q55 4%60) dear and dearest. the inset chart shows that, since May, 3H45 \rightarrow 4Q55 has inverted about 7bp whilst 4Q55 \rightarrow 3H68 has inverted only ≈ 1.5 bp (black line). The rigid forward-rate model spreads this inversion over the whole range, such that each has changed relative pricing by about 3 to 4bp (grey line).

Why have the gilts near 4Q55 become so dear? I'm not in this market at the moment (instead perfecting and marketing a complete solution to the LIBOR problem), so don't know. Is it price-insensitive pension-fund cashflow-matching? If so, it could continue. Is the DMO issuing less 40Y than 30Y and 50Y (but that isn't new)? All very interesting.

It suggests, for those interested in long-term value, the likes of 4Q49 \rightarrow 3H45, or 4Q55 \rightarrow 3H45 & 3H68. But year-end approaches, and repair is unlikely to be that quick.
 — JDAW, 22 Nov 2015, www.jdawiseman.com/gilt_RV.html

x axis = Macaulay-Weil convexity / Macaulay-Weil duration

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 Prices c.o.b. Fri 22 May 2015
 to c.o.b. Fri 20 Nov 2015