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# Instant Thoughts

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## The Chicken Game

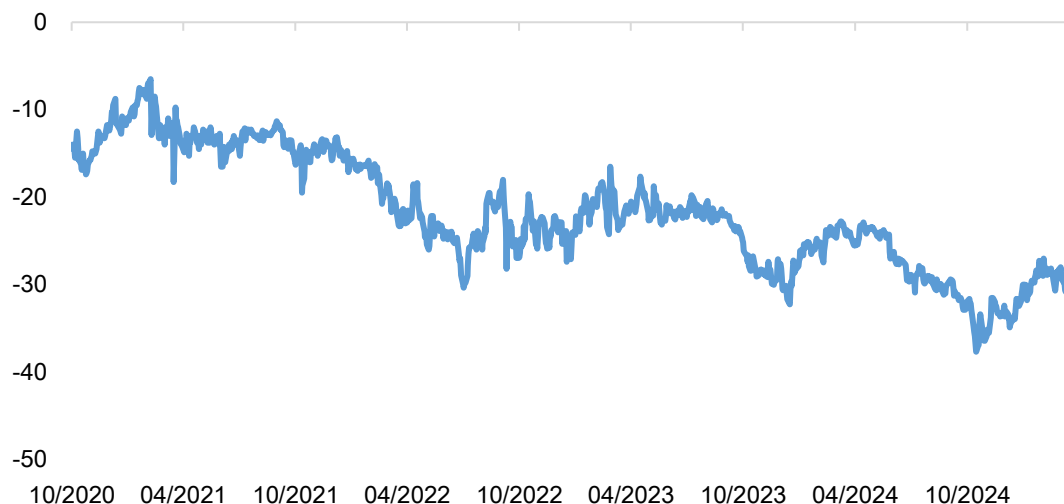
- **The much-watched swap spread is falling even faster than Trump's approval rating. We feel an odd sense of calm, though.**
- **Leveraged fund exposed to basis trade shouldn't be the only suspect beyond the recent liquidation of Treasuries.**
- **We'll genuinely be concerned only if 1) the U.S. repo market exhibits discernible signs of stress, and/or 2) bonds fail to catch a bid during a stock market rout.**
- **Have no illusions even if the swap spread narrows: Unremitting market irregularities are how pessimism becomes embedded. The bulls only return after global acceptance of Trump's design for the post-neoliberal world, which we doubt.**

Trump might have overplayed his hand. The much-watched swap spread is falling even faster than Trump's approval rating, and galloping downwards (Exhibit 1). Overnight SOFR has risen to about 7bp above the effective fed funds rate. Aren't they the chronic symptoms of a "dash for cash"?



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Exhibit 1: 5-year Swap Spread (bp)



Source: Bloomberg, Shanghai Commercial Bank

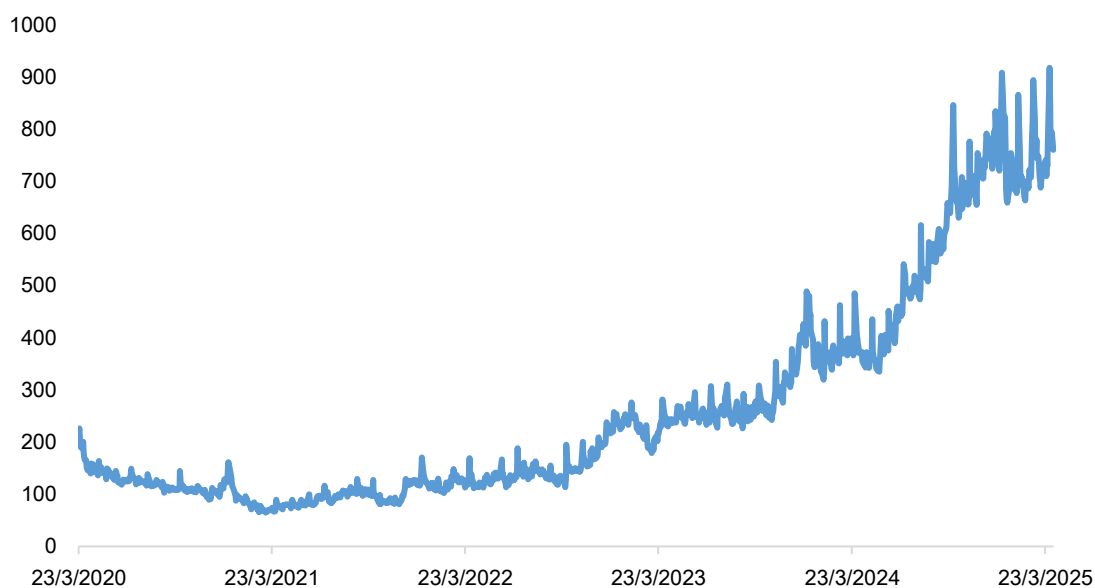
While these are telltale signs of de-leveraging, we feel an odd sense of calm. Leveraged fund exposed to basis trade should be the only suspect beyond the liquidation of Treasuries. Portfolio managers with a 60/40 mandate are equally motivated to sell bonds that have been rather biddish for some times and plow their money into equities. Or, instead of forced selling, markets just front-ran the potential dumping by foreign central bankers.

Most important, we haven't seen a spike in repo activities (Exhibit 2), a sign that the funding from dealers for hedge's basis trades are yet clogged. All basis traders have to do now is to insist for another seven weeks and get out at the first day of June, the crowded delivery date for Treasury futures. That's when we'll see who holds the stronger cards: the short seller or the basis trader. We'll genuinely be concerned only if 1) the U.S. repo market exhibits discernible signs of stress, and/or 2) bonds fail to catch a bid during a stock market rout.



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## Exhibit 2: DTCC Repo Volume (US\$ billion)



Source: Bloomberg, Shanghai Commercial Bank

But have no illusions even if the swap spread narrows: Unremitting market irregularities are exactly how pessimism becomes embedded. Does anyone think a bellicose man willing to slap a 145% tariff on his main business partner will stop at nothing? And after all of these accusations and shaming, why would one assume that global leaders would bend knee and kiss back?

The bulls only return after global acceptance of Trump's design for the post-neoliberal world, which we doubt.



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