

ARTICLE

RELATIVE VALUE OPPORTUNITIES IN THE LONG END OF THE US TREASURY CURVE



By Samuel Kaplan, CFA — May 10, 2024

9 mins

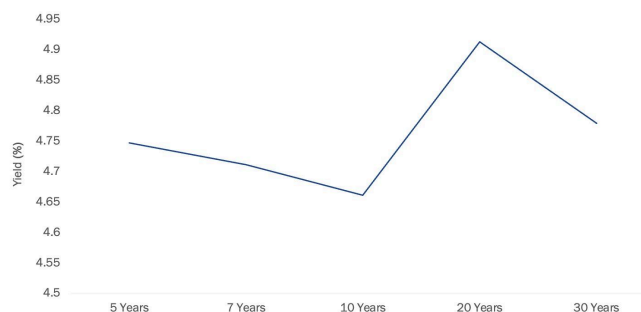
WHY JENNISON BELIEVES THE 20-YEAR POINT IS ATTRACTIVE

In May 2020, the US Treasury reintroduced issuance of “on-the-run” 20-year Treasuries. Increased supply due to fiscal stimulus in the wake of the COVID-19 pandemic coincided with a spike in interest rate volatility, which caused leveraged, short-term investors to unwind their carry trades and sell their positions in longer-dated securities centered on the 20-year point of the US Treasury curve. This resulted in a dislocation in the long end of the US Treasury curve in which 20-year Treasuries yielded more than both 10-year and 30-year Treasuries that started in the fourth quarter of 2021. That dislocation still persists today.

By our measures, the 20-year Treasury offered the most significant relative value in July 2022. Since that time, the 20-year point has outperformed the 10-year and 30-year by ~20 basis points (the 10s-20s curve is 25 basis points flatter and the 20s-30s curve is 18 basis points steeper).

Despite the consistent richening over the last year and a half, the 20-year point continues to be attractive in the current environment, yielding approximately 10 basis points more than 30-year Treasuries and approximately 25 basis points more than 10-year Treasuries (Exhibit 1).

Exhibit 1. 20-Year Treasuries Continue to Offer Attractive Relative Value



Sources: Analytics Provided by The Yield Book® Software. As of April 30, 2024.

The 20-year portion of the yield curve continues to benefit from a confluence of tailwinds. The abnormal supply/demand environment that helped create the uptick in 20-year yields has shifted in the other direction. Recent US Treasury supply increases have been focused on other surrounding parts of the yield curve and the US Treasury's announced buyback program is likely to target higher yielding off-the-run bonds. In our view, this dynamic along with still compelling valuations makes off-the-run bonds in the 20-year part of the Treasury curve one of the most attractive ways to add yield and carry to portfolios from a risk-adjusted return perspective.

HOW JENNISON CAPITALIZES ON THIS MARKET OPPORTUNITY

Treasuries are non-principal at risk trades, which gives Jennison's fixed income team the ability to rotate between bonds without concerns around default risk.

The investment team uses different strategies to capture this market opportunity across Jennison's various fixed income portfolios, all while maintaining duration neutrality versus the respective long duration benchmarks we manage against.

One strategy is a relative value trade, where we buy off-the-run 20-year Treasuries while concurrently selling equal duration off-the-run 15-year and 25-year Treasuries (also known as a butterfly trade). As an example, off-the-run bonds in the 20-year segment are currently yielding approximately 20 basis points more than those in the 15-year segment and are on par with the 25-year segment, illustrating the low-risk nature of adding yield and carry to portfolios through this approach. Furthermore, we believe this strategy makes a fixed income portfolio well positioned to potentially generate alpha as the curve continues to normalize from its extremely dislocated levels (Exhibit 2).

Exhibit 2. Capturing the Relative Value of the 20-Year

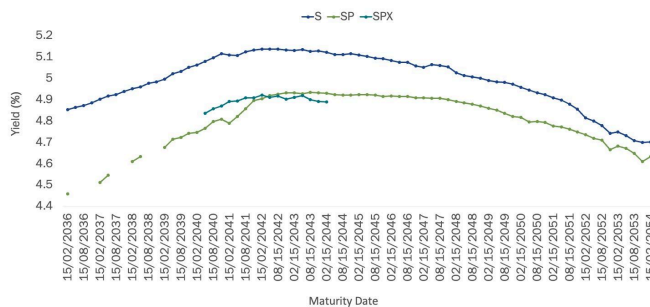


Sources: Jennison Associates LLC and Analytics Provided by The Yield Book® Software, January 31, 1992 - April 30, 2024. The above time frame represents long term historical market cycles.

Additionally, yield and potential returns can be enhanced further by utilizing STRIPS in the 20-year part of the curve. STRIPS allow investors to pay a fraction of a dollar today to get back a full dollar at maturity. Given the lower cash outlay required by STRIPS to get the same duration, excess cash can be allocated to other asset classes with potential attractive returns.

The recent rise in long dated yields coupled with increased stripping activity and demand for 30-year Principal STRIPS (Ps) has led to greater supply of Coupon STRIPS (Coups) across the curve. As a result, the spread between Ps and Coups is at all-time-wide levels (range is 15-25 basis points) in the 20-year part of the curve. For only a small increase in liquidity risk, we believe investors can significantly increase the carry of a portfolio, which can help insulate losses should the 20-year part of the curve start to underperform again, and also boost returns while we wait for curve normalization to occur.

Exhibit 3. Long Dated STRIPS Offer Additional Relative Value Opportunities



Sources: Bloomberg, As of April 30, 2024.

Overall, we believe the 20-year Treasury is a compelling way to increase yield and set-up portfolios for potentially attractive total returns as the yield curve normalizes.



By Samuel Kaplan, CFA
Managing Director, Portfolio Manager, Jennison Associates

A Note About Risk

Investments in bonds are subject to market risks as well as issuer, credit, prepayment, extension, and other risks. The value of an investment is not guaranteed and will fluctuate.

This website is intended for Institutional and Professional Investors only. All investments involve risk, including the possible loss of capital.

Important Disclosures

Jennison Associates is a registered investment advisor under the U.S. Investment Advisers Act of 1940, as amended, and a Prudential Financial, Inc. (“PFI”) company. Registration as a registered investment adviser does not imply a certain level of skill or training. Jennison Associates LLC has not been licensed or registered to provide investment services in any jurisdiction outside the United States. Additionally, vehicles may not be registered or available for investment in all jurisdictions. Prudential Financial, Inc. of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.

Please visit <https://www.jennison.com/important-disclosures> for important information, including information on non-US jurisdictions

This web site is not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services. It does not constitute investment advice, should not be used as the basis for any investment decision, and does not purport to provide any legal, tax or accounting advice. This is for informational and educational purposes only and should not be construed as investment advice or an offer or solicitation in respect of any products or services to any persons who are prohibited from receiving such information under the laws applicable to their place of citizenship, domicile or residence.

The views expressed herein are those of Jennison investment professionals at the time the comments were made and may not be reflective of their current opinions and are subject to change without notice and should not be considered investment advice.

Certain third party information in this material has been obtained from sources that Jennison believes to be reliable as of the date presented; however, Jennison cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. Jennison has no obligation to update any or all such third party information.

Your investment objectives, risk tolerance, and liquidity needs must be reviewed before suitable programs can be recommended. Asset allocation and diversification strategies do not assure a profit or protect against loss in declining markets. Investors should consult with their attorney, accountant, and/or tax professional for advice concerning their particular situation.

Please remember that there are inherent risks involved with investing in the markets, and your investments may be worth more or less than your initial investment upon redemption. There is no guarantee that the investment managers’ objectives will be achieved. Further, there is no assurance that any strategies, methods, sectors, or any investment programs herein were or will prove to be profitable, or that any investment recommendations or decisions we make in the future will be profitable for any investor or client. Professional money management is not suitable for all investors.

There is no guarantee our objectives will be met. All investments contain risk, including possible loss of principal. The strategy may vary significantly from the benchmark in several ways including, but not limited to, sector and issuer weightings, portfolio characteristics, and security types.

Information for persons in the United Kingdom and various European Economic Area jurisdictions

In the United Kingdom, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR. PGIM Limited is authorised and regulated by the Financial Conduct Authority ("FCA") of the United Kingdom (Firm Reference Number 193418). In the European Economic Area ("EEA"), information is issued by PGIM Netherlands B.V. with registered office: Gustav Mahlerlaan 1212, 1081 LA Amsterdam, The Netherlands. PGIM Netherlands B.V. is authorised by the Autoriteit Financiële Markten ("AFM") in the Netherlands (Registration number 15003620) and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited under temporary permission arrangements following the exit of the United Kingdom from the European Union. Jennison Associates LLC, PGIM Limited & PGIM Netherlands B.V. are wholly owned subsidiaries of PGIM, Inc. the principal investment management business of Prudential Financial, Inc. ("PFI"). PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II).

Links to third-party sites are intended for informational purposes only and should not be considered investment advice or recommendation to invest. These links do not constitute endorsement or confirm their accuracy, and we are not responsible for any third-party guidelines, security, or accuracy of information.