US Rates Strategy Weekly

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- **Hedge funds reported nearly $2.4trn of Treasury long positions on their most recent SEC Form PF filings.** Holdings fell $120bn in Q1 26 and their repo borrowings declined $136bn.

- That said, hedge fund long positions have more than doubled since December 2022 and their holdings have grown to around 8% of outstanding public debt.

- **Cash futures basis trades are the single largest hedge fund strategy**, totaling $830bn last September. They also held $375bn in steepeners. We think hedge funds trimmed these positions in Q2 as the yield curve flattened.

- Yields have pushed higher on supply, a hawkish Fed and geopolitical headwinds but we think that these risks are largely priced in. Current yields near the top of the recent range represent increasingly favorable risk-reward for duration buyers.

- Any seasonal vol compression in July should create a buying opportunity. We favor 3m5y or 6m5y structures.

- **We look for overall CPI to hold steady (0.0% m/m) in June with core prices up 0.2% m/m**. Overall CPI is up 3.9% y/y and 2.8% excluding food and energy. **Retail sales are expected to increase 0.4% m/m. Excluding autos, spending is up 0.2% m/m**.

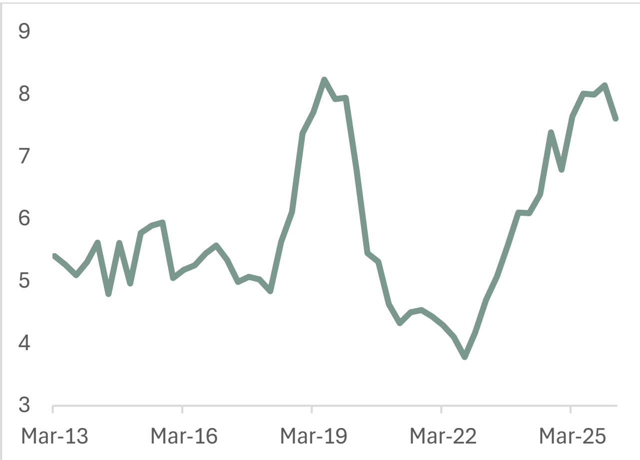
Hedge fund positioning

Hedge funds reported nearly $2.4trn of Treasury long positions on their most recent SEC Form PF filings. And while their holdings fell in March (by $117bn) they are still 7% above year ago levels. In fact, hedge fund long positions have more than doubled since December 2022 and their holdings have grown to around 8% of outstanding public debt (Figure 1). Hedge funds probably reduced their long positions in Q2 given the flattening in the yield curve.

Monin uses hedge funds' Form PF filings to identify the trading strategies behind their long Treasury positions.[1] He breaks the trades into four general types: cash futures, swap spreads, relative value and steepeners. **Cash futures basis trades, where the hedge fund is long a Treasury security and short a future, were the single largest hedge fund strategy, totaling $830bn or 35% of their longs last September**. Hedge fund interest is surprising given the thinness of spreads in TU and FV. Moreover, these bases do not appear to have reacted much to the war, tariffs, or changes in bank regulation. Instead, each has traded in a 1-tick range since early 2025 (Figure 2).

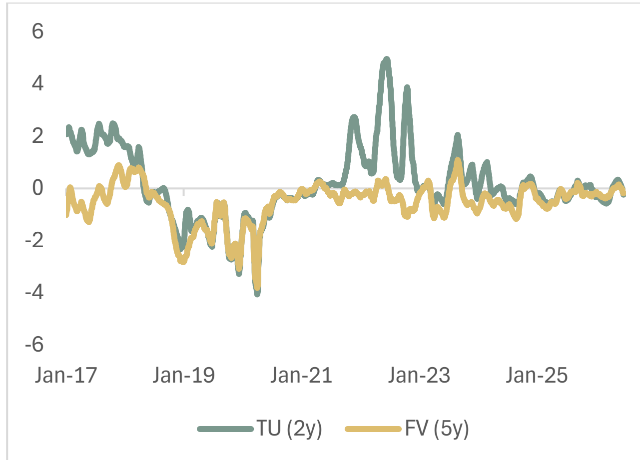
[1] See, "Decomposing Hedge Funds' US Treasury Exposures", P. Monin, Federal Reserve Board, June 22, 2026.

Figure 1: HF Treasury positions (% debt)



Source: SEC, US Treasury, SMBC Nikko

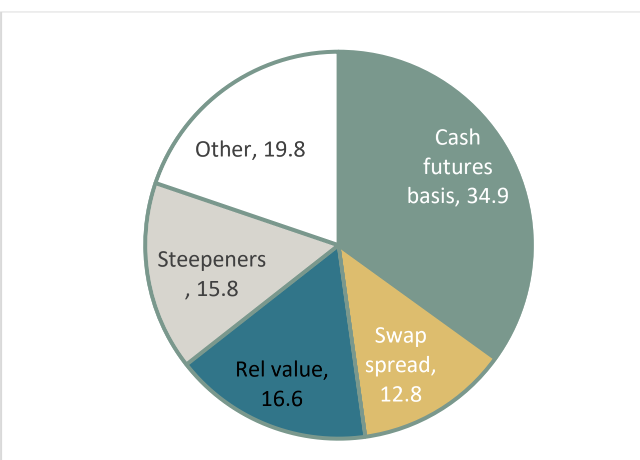
Figure 2: Cash futures basis (32nds)



Source: Bloomberg, SMBC Nikko

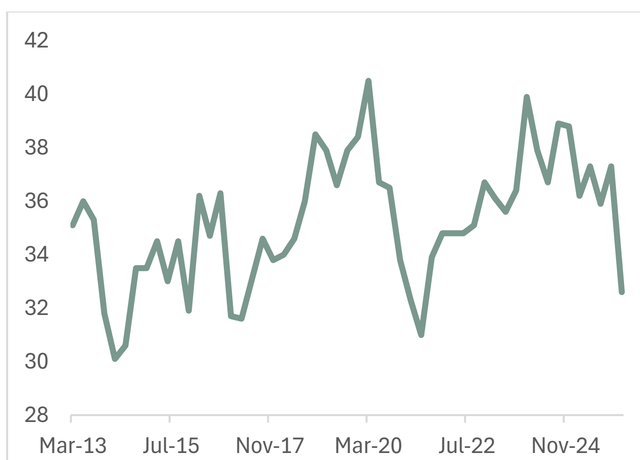
Like the cash futures basis, swap spread trades involve arb'ing a cash Treasury against an interest rate derivative – in this case, a pay fixed/receive floating interest rate swap. Price swings after the April 2025 tariff announcement forced hedge funds to reduce these positions – by about $100bn in April and May or 20%. But funds quickly re-entered the trade in June so that by September, outstandings were unchanged from their March 2025 level. **Separately, Monin reports that hedge funds held about $375bn (16%) in Treasury steepeners last September** and another $395bn was in relative value trades including on-/off-the-runs as well as TIPs against nominals (Figure 3). Other trades include flatteners, unencumbered cash invested in Treasuries as well as simple long positions.

Figure 3: HF long Treasury trades (%)



Note: As a share of hedge fund long Treasury positions. As of September 2025. Source: Monin (2026), SMBC Nikko

Figure 4: Top 10 borrowers (% hedge fund repo)



Source: SEC, SMBC Nikko

These long positions require repo financing. Like their long positions, repo funding has increased significantly – rising to $3.2trn from $1.2trn in 2022. Hedge fund repo borrowing is somewhat concentrated. **The top 10 hedge fund borrowers account for 1/3 or more of overall repo borrowing** (Figure 4). But these borrowers tend to have more counterparties to provide their financing so their creditor concentration is lower than for smaller funds. About half of the repo financing provided to hedge funds comes from US GSIBs.

Hedge fund repo borrowing fell $136bn (4%) in Q1 26. Activity in the sponsored repo market fell 5% (or $60bn) in March and continued to retreat in Q2. Our sense is that the decline in hedge fund demand for financing contributed to the softening in repo rates. And while bill supply has begun rising, repo rates remain comfortable below IORB.

Headwinds but duration near buying zone

The setup coming into July looked constructive for duration. Our expectation was for the 10y Treasury to find support near the 4.50% area, helped by a combination of favorable near-term factors (Figure 5). Chair Warsh struck a more pragmatic tone than markets had feared at Sintra, oil prices retreated toward post-conflict lows, payrolls softened, and July seasonal patterns typically favor bonds through lower volatility and positive carry. While the range broadly remained between 4.35-4.60% through June, the path of least resistance appeared skewed sideways to lower in yield.

But, this constructive thesis has come under pressure:

- Heavy sovereign supply, along with a robust corporate issuance calendar, has weighed on market technicals and given investors little incentive to rush into duration exposure.

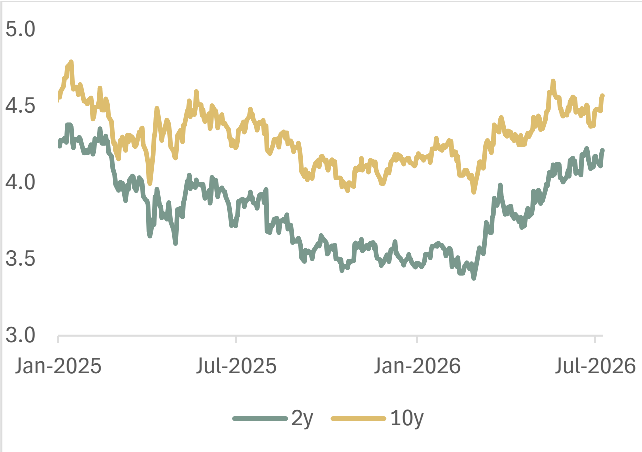
- Investors remain reluctant to extend duration with a still-hawkish Fed backdrop.

- Iran-related uncertainty has re-emerged. While President Trump does not appear inclined to pursue a broader conflict, the situation remains fragile. As a result, markets are likely to retain some geopolitical risk premium.

That said, **we think that much of the supply, fiscal, and geopolitical concern appears priced in at current levels**. The 10-year auction drew very strong investor demand, a sign that real-money investors continue to view yields at these levels as attractive entry points rather than reasons to capitulate on duration (Figure 6).

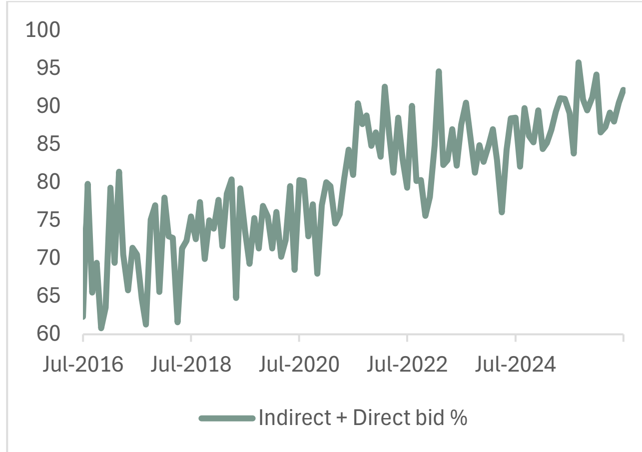
In our view, yields near the top of the recent range represent increasingly favorable risk-reward for duration buyers. Investors should stay cautiously long given the scope for volatility and uncertainty and ready to harvest gains faster than usual.

Figure 5: 2y and 10y UST (%)



Source: Bloomberg, US Treasury SMBC Nikko

Figure 6: 10y UST investor demand (%)



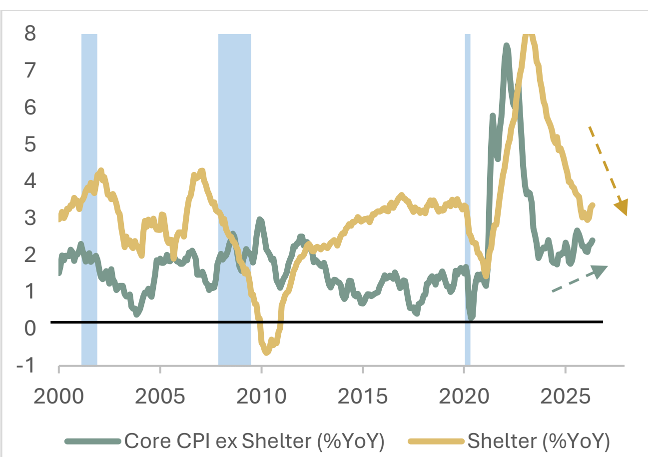
Source: Bloomberg, US Treasury, SMBC Nikko

Week ahead

- **Consumer Prices (Jun, Tues)**: We look for overall CPI to hold steady (0.0% m/m) in June. June CPI would be up 3.9% from a year-earlier. Gasoline prices have fallen as tensions with Iran have eased. Prices were down 9.2% in the month. Core CPI is expected to increase 0.2% m/m or 2.8% y/y. Within the core, we look for shelter costs to edge lower but some of the effect will be muted by an anticipated 0.6% increase in used car prices. Core prices excluding shelter have been rising at a roughly 2% rate since last year (Figure 7).

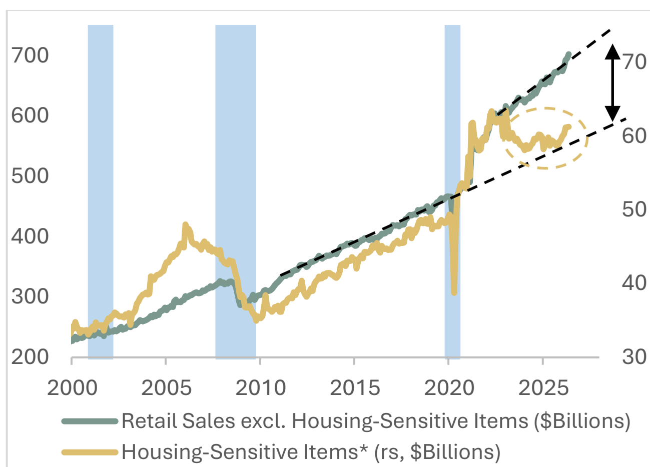
- **Retail Sales (June, Thurs)**: Retail sales are expected to increase 0.4% m/m in June with ex auto spending likely to increase 0.2% m/m. Unit auto sales rose 2.8% in June, but gasoline prices fell more than 9% reducing the increase in nominal spending. Real retail sales have moved sideways since April 2021 but excluding sales of furniture and home improvements, the trend in real retail spending is higher (Figure 8).

Figure 9: Core CPI excluding Shelter (%YoY) vs Shelter (%YoY)



Source: BLS, Haver, SMBC Nikko

Figure 10: Retail Sales ex Housing-Sensitive items ($Billions) vs Housing Sensitive Retail Sales ($Billions)



Source: Census, Haver, SMBC Nikko

Table 3: Economic indicator forecasts

SMBC US Forecasts						
Date	Indicator	SMBC Forecast	Market Consensus (Median)	Prior	Range of Est.	Notes:
Jul 14	CPI MoM (8:30 AM)	-0.02%	-0.1%	0.5%	-0.2% - +0.3%	Gasoline prices fell -9.2% in June. We are forecasting: CPI energy at -3.7%, core at +0.22%. Food at +0.5%.
Jul 14	CPI YoY (8:30 AM)	3.96%	3.9%	4.2%	3.6% - +4.2%	Post Iran MOU: we are forecasting headline CPI to end the year at 3.6% YoY.
Jul 14	Core CPI MoM (8:30 AM)	0.22%	0.3%	0.2%	0.2% - +0.3%	Forecasting: core ex shelter at 0.14%, shelter at 0.22%. Upside risk. Used car prices +0.6% MoM (Manheim).
Jul 14	Core CPI YoY (8:30 AM)	2.89%	2.9%	2.9%	2.8% - +2.9%	Forecasting modest progress in core CPI by yearend, to 2.7% YoY.
Jul 15	PPI MoM (8:30 AM)	0.0%	0.0%	1.1%	-0.2% - +0.5%	Crude Oil sensitive. WTI fell -17% MoM. Brent -18.2% MoM.
Jul 15	Core PPI MoM (8:30 AM)	0.4%	0.4%	0.4%	0.2% - +0.6%	Bloomberg commodity index fell -7.6% MoM.
Jul 16	Retail Sales (8:30 AM)	0.4%	0.3%	0.9%	-0.2% - +0.6%	Gasoline prices fell -9.2% in June.
Jul 16	Retail Sales ex autos (8:30 AM)	0.2%	-0.1%	0.8%	-0.4% - +0.5%	Auto sales rose 2.8% MoM (BEA).
Jul 17	Housing Starts (8:30 AM)	4.2%	11.5%	-15.4%	8.9% - +17.0%	Housing starts have normalized back to pre-covid levels, and trending lower due to weak housing demand.
Jul 17	Industrial Production (9:15 AM)	0.2%	0.2%	0.1%	-0.3% - +0.6%	Expecting a mechanical pickup in manufacturing production to +0.4% MoM.
Jul 17	U Michigan Consumer Sentiment (10 AM)	51.2	51.3	49.5	49.0 - 52.0	Falling gas prices and higher news sentiment index (SF Fed) to feed into higher consumer sentiment.

Forecasts subject to change

Source: SMBC Nikko Securities US Economics Forecasts

Disclaimers