US Rates Strategy

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Estimating hedge funds' Treasury swap activity

Hedge funds' long Treasury positions have more than doubled since the pandemic. Much of this growth has occurred since late last year and likely reflects relative value trades keyed to expectations of SLR relief. The long cash positions require growing amounts of repo funding.

- Hedge fund long Treasury cash and futures positions have risen $1.4trn since March 2022. **About $350bn of this has occurred since December 2024**.

- **Much of this growth probably reflects interest in relative value trades including Treasury interest rate swaps and cash/futures basis**. Following the election there were widespread expectations that SLR relief would sharply increase bank demand for Treasuries.

- **Hedge fund Treasury swap positions were around $750bn at the end of September**. Measurement issues mean this amount is an upper boundary of the size of the trade. This would make it smaller than their estimated cash/futures basis activity.

- Funds use repo to finance the long side of their relative value trades. **Since December 2024, hedge fund repo borrowings have increased nearly 30% ($690bn), much of it ($310bn) by the ten largest funds by gross assets**.[1] By strategy, secured borrowings have increased most at multistrat and relative value funds.

- **The balance sheet strain that this might have created for dealers has been offset by increased sponsored repo financing**. In the year through September 2025, cash borrowed via sponsored repo rose 60% or nearly $500bn.

- **However, since year-end demand for sponsored repo has fallen sharply**. It is too soon to tell if this is seasonal or a retrenchment in relative value trade demand.

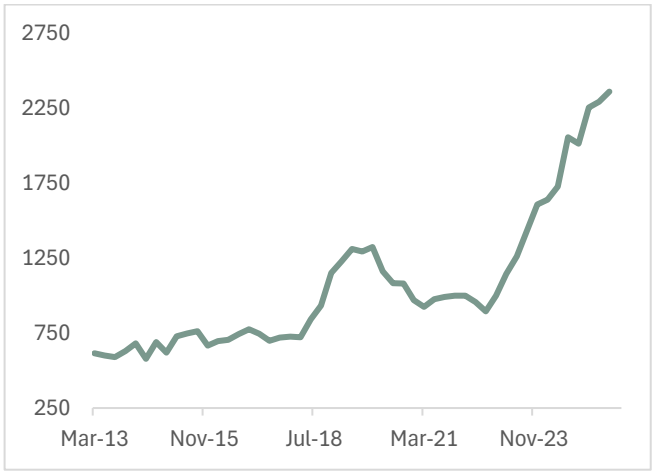
Long positions

Hedge funds' long cash and futures positions have grown $1.4trn since the end of COVID and reached $2.4trn as of September 2025 (Figure 1).[2] Their holdings are about $1trn larger than their prior peak in 2019. About a quarter of the increase has occurred since December 2024. **Why are hedge funds so bullish on Treasuries, and what changed last year**?

[1] Repo totals include all collateral. We cannot determine what portion is against Treasuries.
[2] Based on statistics collated by the Office of Financial Research and collected from the SEC's Form PF.

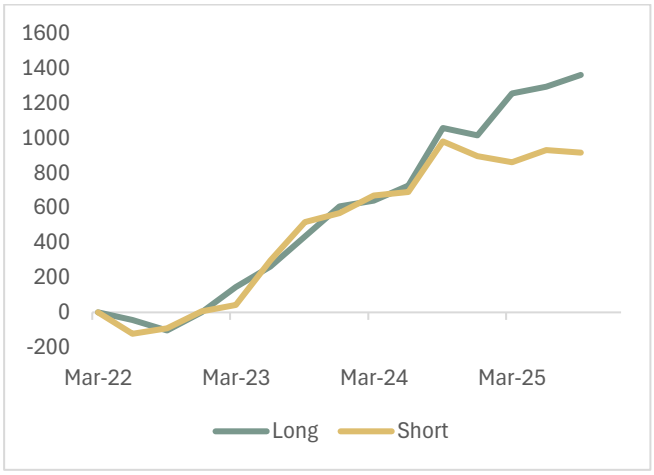
We think the growth likely reflects hedge funds' increased interest in two types of relative value trades: cash/futures basis and Treasury interest rate swaps. In the former, the investor is long a Treasury which it expects to deliver into a futures contract (i.e, it is short futures). The investor makes a profit if the basis narrows - either because the Treasury rallies or the futures cheapens. Because the OFR data include futures, growth in cash/futures basis activity should be reflected as similarly sized increases in both short and long positions. In Figure 2, we plot the cumulative growth (in billions of dollars) of both since Q1 22. Through September 2024, both were growing at roughly the same pace. Afterwards, long positions began to grow faster. **Since September 2024, the gap between longs and shorts has doubled and exceeds $750bn** (Figure 3).

Figure 1: Long Treasury positions ($bn)



Source: OFR, SMBC Nikko

Figure 2: Long and short positions (change, $bn)



Note: Cumulative change since March 2022. Source: OFR, SMBC Nikko

Our sense is that the divergence between hedge fund longs and shorts reflects rising interest in Treasury interest rate swaps. Here investors combine a long Treasury position with an interest rate swap paying fixed. The goal is to earn more on the Treasury than the cost of paying fixed. The OFR data do not include both legs of this trade as the interest rate swap is an exchange of interest rate payments rather than a delivery of Treasuries. As a result, it is possible to estimate an upper boundary for the size of swap activity. That said, hedge funds may be long Treasuries for other reasons than relative value trading so the difference between long and short positions likely overstates their interest rate swaps activity. Coverage issues also affect estimates of their cash/futures basis trading. Sushko and Todorov put the cash/futures basis trades at around $1.1trn as of June 2025.[3] However, other estimates of the cash/futures basis trade range from as low as $300bn to perhaps as much as $1.4trn.[4]

Regardless of the exact dimension of these trades, hedge funds' relative value activity has increased – especially since late 2024. We believe this reflects widespread post-election expectations that the new administration would reduce the eSLR (enhanced supplemental leverage ratio) to free up

[3] See "Sizing up hedge funds' relative value trades in US Treasuries and interest rate swaps", V. Sushko and K. Todorov, BIS Quarterly Review, December 2025.
[4] See, "Quantifying Treasury Cash Futures Basis Trades", J. Glicoes, B. Iorio, P. Monin, and L. Petrasek, Federal Reserve Board, March 8, 2024 (low estimates) and "The Cross Boder Trail of the Treasury Basis Trade", D. Barth, D. Beltran, M. Hoop, J. Kahn, E. Liu, and M. Perozek, Federal Reserve Board, October 15, 2025 (higher estimates).

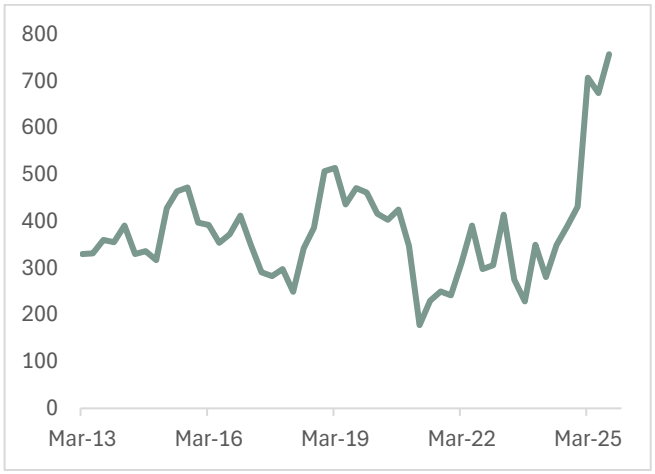
bank balance sheets to buy more Treasuries. This was expected to increase their Treasury demand by more than $2trn and simultaneously expand their repo lending. There was a brief reversal in relative value trading after the Liberation Day tariffs caused Treasury yields to spike. But volumes recovered quickly and even increased *after* the Fed's June capital rule proposal contained no mention of any Treasury exclusion. Instead, the proposed capital relief was concentrated at the depository level rather than the holding company level where more of their repo activity occurs.

Repo funding

Both types of relative value trades involve a long Treasury position that is typically funded in repo. It is difficult to directly compare hedge fund repo borrowings in the Form PF data against the increase in Treasury long positions because the repo figures include *all* collateral types and the Treasury longs include futures which are not financed in repo. That said, hedge fund repo volumes have increased sharply side-by-side with the increase in their long Treasury positions (Figure 4). At just under $3trn, repo volumes are more than twice their prior peak in 2019.

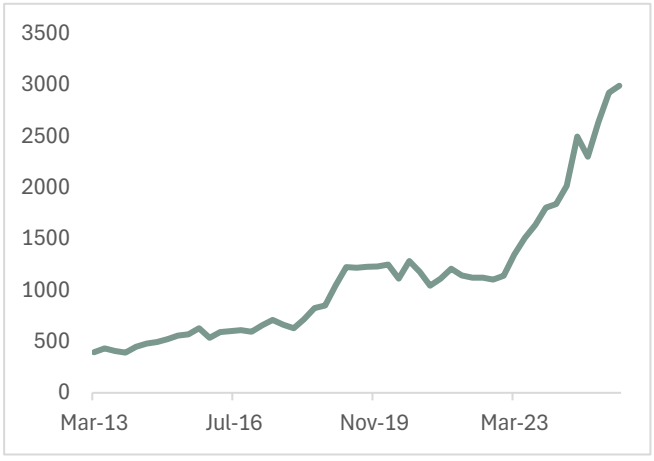
Since December 2024, hedge fund repo volumes have risen nearly 30% or $690bn. Just under half of this amount ($310bn) has come from increased borrowing at the ten largest funds by gross assets. These funds typically have more than 20 different counterparties and, like their smaller counterparts, nearly all their funding is raised from GSIB banks.[5] By strategy, the biggest increase in borrowing over the period has come from multistrat funds ($730bn) and relative value funds ($375bn).[6] Conversely, macro funds have reduced their borrowing.

Figure 3: Estimated Treasury swaps ($bn)



Note: Upper boundary. Source: OFR, SMBC Nikko

Figure 4: Hedge fund repo volume ($bn)



Note: Cash in/securities out. Source: OFR, SMBC Nikko

Despite substantially more hedge fund repo borrowing than in 2019, there has been no spike in funding rates. Instead, the increase in repo rates last fall was driven primarily by the decline in bank reserves. **As hedge fund demands to finance the cash leg of their relative value trades surged, access to central clearing has increased dealers' ability to provide this funding**. Since 2022, sponsored repo volumes

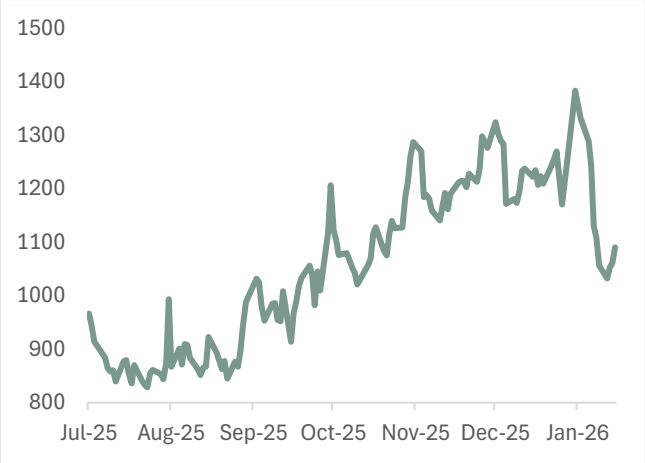
[5] 52% from domestic GSIBs and 34% from non-US GSIBs.
[6] Borrowing includes all sources of secured borrowing including prime brokerage and trades collateralized with cash.

have increased 10-fold, and between December 2024 and September 2025, the volume of cash borrowed through sponsored repo has increased nearly $500bn or 60%.

Curiously, sponsored repo volumes have fallen sharply since the start of the year (Figure 5). It is not clear how much of this might be seasonal. After all, hedge funds and dealers move to preserve balance sheet at year-end by ramping up their sponsored activity. Once the reporting date has passed, they may become less aggressive about netting down balance sheet. Part of this is because sponsored repo is not costless; the FICC applies its own VaR based haircuts on activity. Most (but not all) of these margins are currently paid by the dealer.

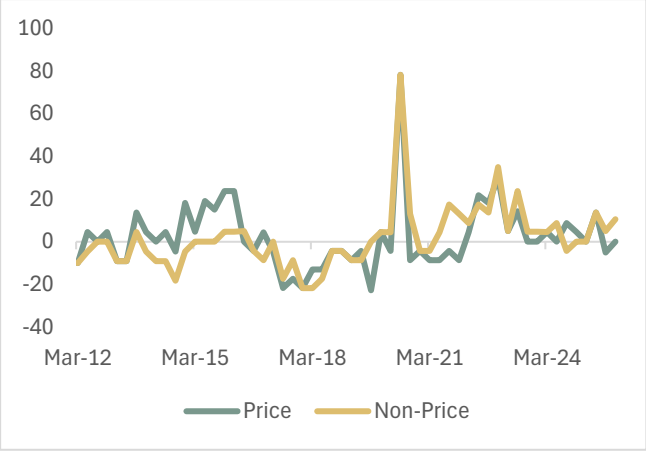
Alternatively, it might reflect a genuine decline in hedge fund appetite for some relative value trades as policy expectations have shifted since the start of the year. Any shift in sentiment, however, is very recent. The Fed's most recent Survey of Senior Credit Officer's Opinion Survey (through December) shows little change in hedge fund leverage demand. Likewise, the 19 participating dealers did not report any change in price (rate) or non-price (haircut) trade terms with hedge funds (Figure 6).

Figure 5: Sponsored repo volume ($bn)



Source: DTCC, SMBC Nikko

Figure 6: Net share reporting tighter terms (%)



Source: Federal Reserve SCOOS, SMBC Nikko

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