

## Yield curve strategy – calendar spread

### Situation

An investor anticipates a steepening of the short-term yield curve.

### Objective

The investor would like to profit from a possible change in the yield curve in the next month.

### Strategy

#### MARKET CONDITIONS ON AUGUST 1<sup>ST</sup>

BAX, September contract:	92.37
BAX, December contract:	93.20

Given that the investor expects a normalization of the yield curve (an increase in long-versus short-term rates), he will buy the nearest month BAX contract (September BAX) and sell the farthest month BAX (December BAX). This strategy is called a calendar spread. The investor will buy 50 September BAX contracts and sell 50 December BAX contracts on August 1st and will ultimately reverse the position on September 17th by selling 50 September BAX contracts and buying 50 December BAX contracts.

### Results

#### MARKET CONDITIONS ON SEPTEMBER 17<sup>TH</sup>

BAX, September contract:	92.15
BAX, December contract:	92.85

Loss on the September BAX position:  
 $50 \text{ contracts} \times (92.37 - 92.15) \times 100 \text{ basis points per contract} \times \$25 \text{ per basis point} = (\$27,500)$

Gain on the December BAX position:  
 $50 \text{ contracts} \times (93.20 - 92.85) \times 100 \text{ basis points per contract} \times \$25 \text{ per basis point} = \$43,750$

Profit from calendar spread = \$16,250

### Comment

This type of yield curve view can be expressed using different horizons within the Canadian yield curve. Many portfolio managers use the BAX/CGB\* spread to take advantage of a change (flattening, steepening) in the Canadian yield curve.

\* CGB: 10-year Government of Canada Bond Futures