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CME Group

Riding the Fed's Wake – Strategies with Treasury and Currency Futures

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As with all investments, your capital is at risk



GFM
ASSET MANAGEMENT

Riding the Fed's Wake

Strategies with FX and
Micro Treasury Futures
by Tariq Dennison
17 April 2024

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About Tariq Dennison

- Independent Advisor on IBKR Platform
 -  GFM Asset Management LLC
 -  GFM Group Limited
 -  Dennison Wealth
- Futures, Options, Stocks & Bonds Since 1998
 - Firms: Bear Stearns, J.P Morgan, CIBC, Société Générale (HK)
 - Cities: SF, NY, Toronto, London, Hong Kong, Singapore, and now Zürich
 - Instruments: stocks, bonds, ETFs, swaps, futures & options
- Author of “Invest Outside the Box”, “10 Ways To Invest”, over 200 articles & masters courses, frequent guest on CNBC Asia.



Outline

- The Fed, The Fed Funds Rate, and why it matters
- The Fed's impact on bond markets
- The Fed's impact on FX / currency markets
- Capturing bond moves with CME's new micro treasury futures
- How to use FX / currency futures

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What is the Fed Funds rate?

US Federal Reserve
(FOMC)



Policy target
rate:
5.25 – 5.5%

Member banks
transact with the Fed

Your local bank



Fed funds
effective rate:
5.33%

Prime rate =
FF + 3% =
8.5%

Broker “call
money” rate =
FF + 1.75% =
7.25%

High yield
savings account:
4.75%

Checking
account:
0 - 1%

Image source: <https://www.gao.gov/blog/2019/09/17/the-decentralized-structure-of-the-federal-reserve-system> , <https://www.nps.gov/mawa/the-st-luke-penny-savings-bank.htm>

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One way to earn close to the Fed Funds rate

	LAST	BID	YIELD	ASK	YIELD	TM-T-...	FC	VL
US-T GOVT Bill Apr30'24 912797JQ1	99.51880	◆	5.385%	5.341%	◆	0.09	1000.0	
US-T GOVT Bill Jun27'24 912796Y45	98.68175	◆	5.390%	5.400%	◆	0.25	1000.0	
US-T GOVT Note 4.0 Feb15'26 91282CGL9 AAA	98.87305	◆	4.632%	4.626%	◆	1.89	1000.0	
US-T GOVT Note 4.0 Feb15'34 91282CJZ5 AAA	98.46095	◆	4.192%	4.190%	◆	9.89	1000.0	
US-T GOVT 4.25 Feb15'54 912810TX6 AAA	98.31750	◆	4.352%	4.350%	◆	29.89	1000.0	
US-T GOVT TIPS 0.125 Feb15'52 912810TE8 AAA	58.73860	◆	2.092%	2.075%	◆	27.89	1000.0	
US-T GOVT TIPS 2.125 Feb15'54 912810TY4	100.909...	◆	2.088%	2.080%	◆	29.89	1000.0	

Image source: IBKR TWS, 28 March 2024 12:05 CET

For more on this, see: <https://ibkrcampus.com/webinars/how-to-find-and-choose-different-bonds-in-2024/>

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One place to see the Fed Funds rate

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Effective Federal Funds Rate

The federal funds market consists of domestic unsecured borrowings in U.S. dollars by depository institutions from other depository institutions and certain other entities, primarily government-sponsored enterprises.

The effective federal funds rate (EFFR) is calculated as a volume-weighted median of overnight federal funds transactions reported in the FR 2420 Report of Selected Money Market Rates. The New York Fed publishes the EFFR for the prior business day on the New York Fed's website at approximately 9:00 a.m.

For more information on the EFFR's publication schedule and methodology, see [Additional Information about Reference Rates Administered by the New York Fed](#).

The Federal Open Market Committee establishes the target rate, or range, for trading in the federal funds market.

Resources

- [About the Reference Rates](#)
- [Statements and Operating Policies](#)
- [Additional Information about Reference Rates Administered by the New York Fed](#)
- [Markets Data APIs](#)

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FEDERAL FUNDS DATA

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DATE	RATE (%)	1ST PERCENTILE (%)	25TH PERCENTILE (%)	75TH PERCENTILE (%)	99TH PERCENTILE (%)	VOLUME (\$Billions)	TARGET RATE/RANGE (%)
03/26	5.33	5.31	5.32	5.34	5.45	85	5.25 - 5.50
03/25	5.33	5.31	5.32	5.34	5.46	85	5.25 - 5.50
03/22	5.33	5.31	5.32	5.34	5.45	91	5.25 - 5.50
03/21	5.33	5.31	5.32	5.34	5.45	93	5.25 - 5.50
03/20	5.33	5.31	5.32	5.34	5.45	91	5.25 - 5.50

Image source: <https://www.newyorkfed.org/markets/reference-rates/effr>

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Charting the Fed Funds rate over time

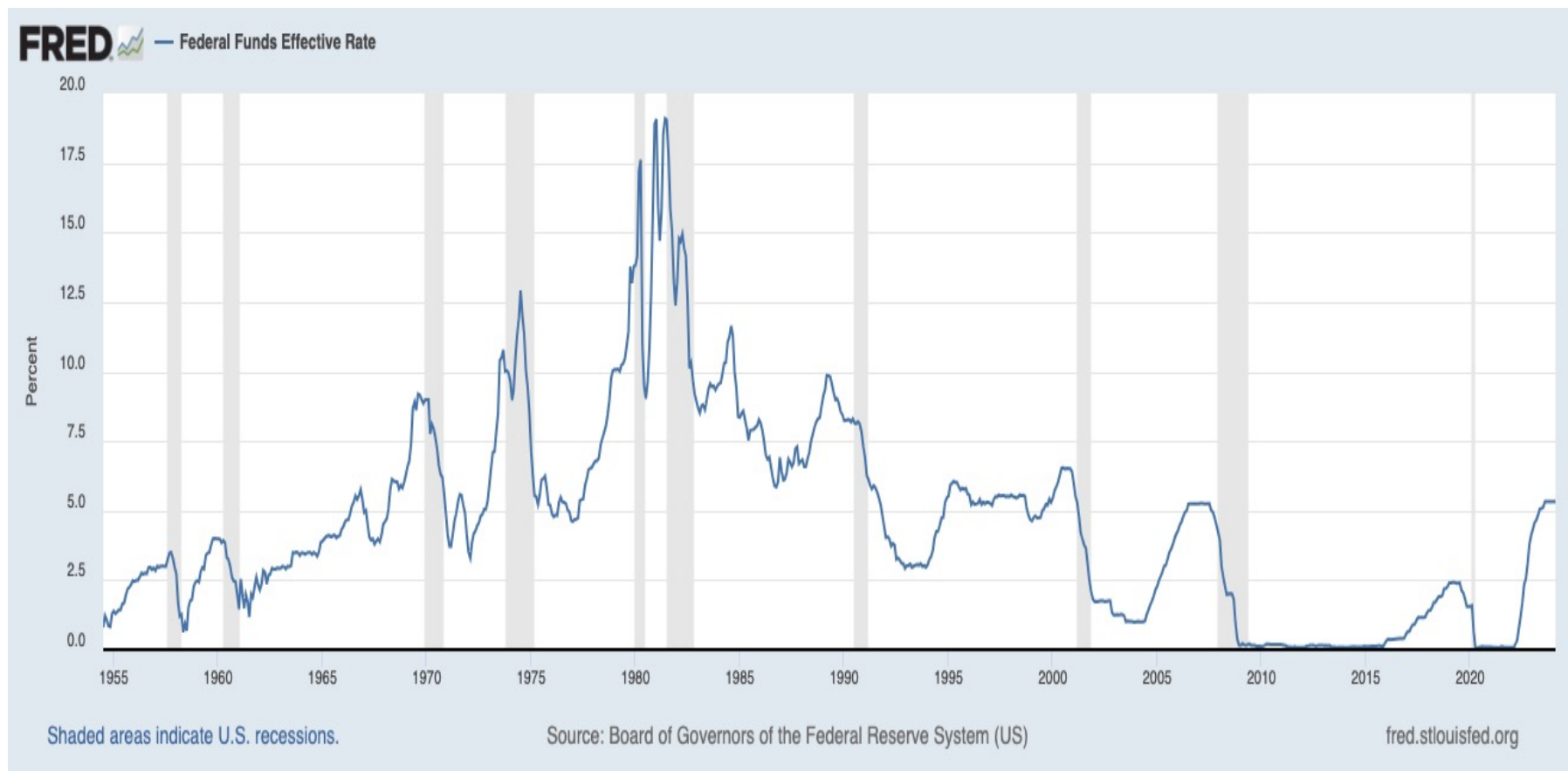


Image source: <https://fred.stlouisfed.org/series/FEDFUNDS#>

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Why hike rates

- Encourage savings
- Discourage borrowing
- Reduce **demand** pressure on inflation
(fewer dollars chasing same goods)
- Strengthen US dollar
- Reduce cost of imports
- Devalue impact of overseas profits

Why cut rates

- Discourage savings
- Encourage borrowing
- Increase **demand** pressure on inflation
(more dollars chasing same goods)
- Weaken US dollar
- Increase cost of imports
- Increase impacts of inflows from abroad

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Where the market prices future rate moves: 100 - R

		LAST	CHANGE	
ZQ Apr30'24 @CBOT	◆	94.675	+0.005	0.01%
ZQ May31'24 @CBOT	◆	94.695	-0.010	-0.01%
ZQ Jun28'24 @CBOT	◆	94.780	-0.020	-0.02%
SOFR3 Mar'24 @CME	◆	94.6725	-0.0025	0.00%
SOFR3 Jun'24 @CME	◆	94.860	-0.025	-0.03%
SOFR3 Sep'24 @CME	◆	95.130	-0.050	-0.05%
SOFR3 Dec'24 @CME	◆	95.425	-0.060	-0.06%
SOFR3 Mar'25 @CME	◆	95.700	-0.060	-0.06%
SOFR3 Jun'25 @CME	◆	95.930	-0.065	-0.07%
SOFR3 Sep'25 @CME	◆	96.105	-0.070	-0.07%
SOFR3 Dec'25 @CME	◆	96.230	-0.060	-0.06%
SOFR3 Mar'26 @CME	◆	96.305	-0.055	-0.06%

Image source: IBKR TWS, 28 March 2024 13:05 CET

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Translating this with CME's "FedWatch Tool"

FedWatch Tool

Target Rate

Current

Compare

Probabilities

Historical

Historical

Downloads

Prior Hikes

Dot Plot

Chart

Table

Tools

CVOL

SOFR Watch

FED FUND FUTURES

ZQH4	ZQJ4	ZQK4	ZQM4	ZQN4	ZQQ4	ZQU4	ZQV4	ZQX4	ZQZ4	ZQF5	ZQG5	ZQH5
94.6688	94.6738	94.6975	94.7825	94.8425	94.9375	95.0100	95.1175	95.2125	95.3125	95.4225	95.5350	95.5950

CME FEDWATCH TOOL - MEETING PROBABILITIES

MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
5/1/2024				0.0%	0.0%	0.0%	0.0%	4.2%	95.8%
6/12/2024	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.6%	61.0%	36.4%
7/31/2024	0.0%	0.0%	0.0%	0.0%	0.0%	1.0%	25.5%	51.3%	22.1%
9/18/2024	0.0%	0.0%	0.0%	0.0%	0.7%	18.7%	44.1%	30.3%	6.2%
11/7/2024	0.0%	0.0%	0.0%	0.3%	8.9%	30.3%	37.8%	19.3%	3.4%
12/18/2024	0.0%	0.0%	0.2%	6.5%	24.2%	35.7%	24.6%	7.9%	1.0%
1/29/2025	0.0%	0.1%	3.4%	15.3%	29.9%	30.1%	16.3%	4.4%	0.5%
3/19/2025	0.1%	2.0%	10.2%	23.7%	30.0%	22.1%	9.4%	2.2%	0.2%
4/30/2025	0.9%	5.4%	15.8%	26.3%	26.8%	16.9%	6.4%	1.4%	0.1%

CME FEDWATCH TOOL - TOTAL PROBABILITIES

MEETING DATE	DAYS TO MEETING	EASE	NO CHANGE	HIKE
5/1/2024	34	4.23 %	95.77 %	0.00 %
6/12/2024	76	63.61 %	36.39 %	0.00 %
7/31/2024	125	77.90 %	22.10 %	0.00 %
9/18/2024	174	93.81 %	6.19 %	0.00 %
11/7/2024	224	96.64 %	3.36 %	0.00 %
12/18/2024	265	99.04 %	0.96 %	0.00 %
1/29/2025	307	99.52 %	0.48 %	0.00 %
3/19/2025	356	99.80 %	0.20 %	0.00 %
4/30/2025	398	99.88 %	0.12 %	0.00 %

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Image source: <https://www.cmegroup.com/markets/interest-rates/cme-fedwatch-tool.html> , 28 March 2024 13:47 CET

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Charting 10-year yields over the Fed Funds rate

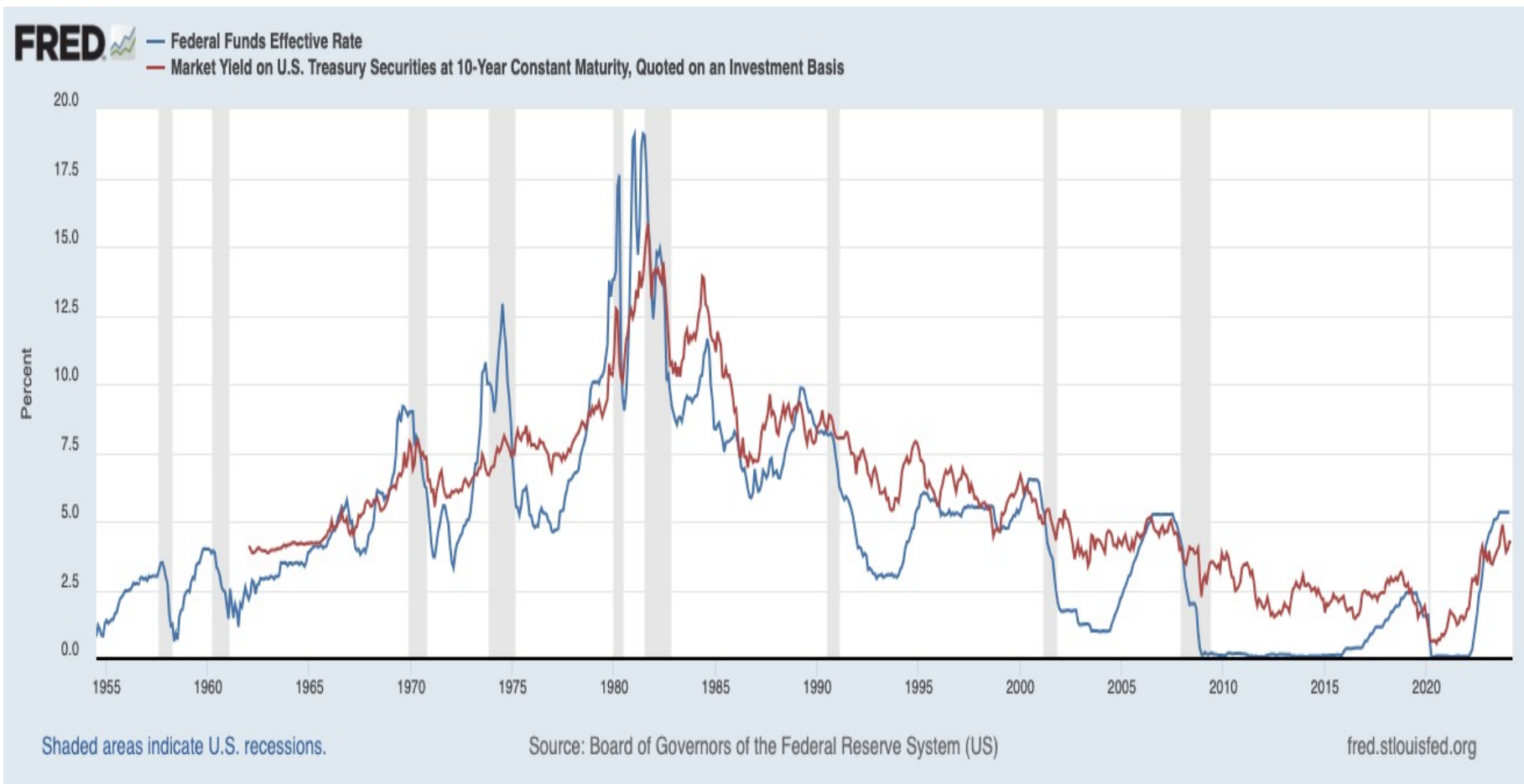


Image source: <https://fred.stlouisfed.org/series/FEDFUNDS#>

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How “Ultra” 10-year Note Futures Work

10-YEAR "ULTRA" U.S. TREASURY NOTE FUTURES CONTRACT

Coupon	Issue Date	Maturity Date	Cusip Number	Issuance (Billions)	Mar. 2024	Jun. 2024	Sep. 2024
					0.8507	—	—
3 7/8	08/15/23	08/15/33	91282CHT1	\$108.0	0.8507	—	—
4 1/2	11/15/23	11/15/33	91282CJJ1	\$114.0	0.8926	0.8946	—
4	02/15/24	02/15/34	91282CJZ5	\$81.0	0.8539	0.8568	0.8595

	LAST	BID	YIELD	ASK	YIELD	TM-T-...
US-T GOVT Note 3.875 Aug15'33 91282CHT1 AAA	97.29497	4.227%	4.227%	9.38		
US-T GOVT Note 4.5 Nov15'33 91282CJJ1 AAA	102.14648	4.226%	4.225%	9.63		
US-T GOVT Note 4.0 Feb15'34 91282CJZ5 AAA	98.26367	4.217%	4.216%	9.89		

$$102.15 / 0.8946 = 114.18$$

$$102.15 / 0.8946 = 114.68$$

Between now and the June delivery, the **seller** of this future:

- Prices in the accrued interest earned on each note
- Prices the cost of borrowing the money to own each note
- Has the option to deliver the **cheapest** of these bonds

Arbitrage and competition keep these futures priced close to where institutions trade and fund benchmark treasuries

Image source: <https://www.cmegroup.com/trading/interest-rates/treasury-conversion-factors.html>
IBKR TWS, 28 March 2024 14:30 CET

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Ultra Long Bond Futures Have A Few More

LONG-TERM "ULTRA" U.S. TREASURY BOND FUTURES CONTRACT

Coupon	Issue Date	Maturity Date	Cusip Number	Issuance (Billions)	Mar. 2024	Jun. 2024	Sep. 2024	Dec. 2024	Mar. 2025
2 7/8	05/15/19	05/15/49	912810SH2	\$51.0	0.5980	---	---	---	---
2 1/4	08/15/19	08/15/49	912810SJ8	\$51.0	0.5154	0.5176	---	---	---
2 3/8	11/15/19	11/15/49	912810SK5	\$51.0	0.5296	0.5316	0.5336	---	---
2	02/18/20	02/15/50	912810SL3	\$52.0	0.4788	0.4810	0.4831	0.4854	---
1 1/4	05/15/20	05/15/50	912810SN9	\$60.0	0.3786	0.3811	0.3837	0.3862	0.3889
1 3/8	08/17/20	08/15/50	912810SP4	\$72.0	0.3924	0.3949	0.3973	0.3999	0.4024
1 5/8	11/16/20	11/15/50	912810SS8	\$75.0	0.4230	0.4253	0.4276	0.4299	0.4323
1 7/8	02/16/21	02/15/51	912810SU3	\$75.0	0.4539	0.4560	0.4581	0.4603	0.4625
2 3/8	05/17/21	05/15/51	912810SX7	\$75.0	0.5183	0.5201	0.5220	0.5238	0.5257
2	08/16/21	08/15/51	912810SZ2	\$75.0	0.4664	0.4684	0.4704	0.4725	0.4745
1 7/8	11/15/21	11/15/51	912810TB4	\$69.0	0.4478	0.4498	0.4518	0.4539	0.4560
2 1/4	02/15/22	02/15/52	912810TD0	\$63.0	0.4961	0.4980	0.4998	0.5017	0.5035
2 7/8	05/16/22	05/15/52	912810TG3	\$60.0	0.5787	0.5801	0.5816	0.5831	0.5847
3	08/15/22	08/15/52	912810TJ7	\$57.0	0.5941	0.5955	0.5969	0.5984	0.5998
4	11/15/22	11/15/52	912810TL2	\$57.0	0.7285	0.7293	0.7303	0.7312	0.7323
3 5/8	02/15/23	02/15/53	912810TN8	\$57.0	0.6764	0.6776	0.6786	0.6798	0.6808
3 5/8	05/15/23	05/15/53	912810TR9	\$57.0	0.6754	0.6764	0.6776	0.6786	0.6798
4 1/8	08/15/23	08/15/53	912810TT5	\$63.0	0.7429	0.7438	0.7445	0.7455	0.7462
4 3/4	11/15/23	11/15/53	912810TV0	\$66.0	0.8281	0.8285	0.8292	0.8297	0.8303
4 1/4	02/15/24	02/15/54	912810TX6	\$47.0	0.7585	0.7593	0.7600	0.7609	0.7616

Image source: <https://www.cmegroup.com/trading/interest-rates/treasury-conversion-factors.html>

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2 7/8	05/15/19	05/15/49	912810SH2	\$51.0	0.5980	---	---	---	---
2 1/4	08/15/19	08/15/49	912810SJ8	\$51.0	0.5154	0.5176	---	---	---
2 3/8	11/15/19	11/15/49	912810SK5	\$51.0	0.5296	0.5316	0.5336	---	---
2	02/18/20	02/15/50	912810SL3	\$52.0	0.4788	0.4810	0.4831	0.4854	---
1 1/4	05/15/20	05/15/50	912810SN9	\$60.0	0.3786	0.3811	0.3837	0.3862	0.3889
1 3/8	08/17/20	08/15/50	912810SP4	\$72.0	0.3924	0.3949	0.3973	0.3999	0.4024
1 5/8	11/16/20	11/15/50	912810SS8	\$75.0	0.4230	0.4253	0.4276	0.4299	0.4323
1 7/8	02/16/21	02/15/51	912810SU3	\$75.0	0.4539	0.4560	0.4581	0.4603	0.4625
2 3/8	05/17/21	05/15/51	912810SX7	\$75.0	0.5183	0.5201	0.5220	0.5238	0.5257
2	08/16/21	08/15/51	912810SZ2	\$75.0	0.4664	0.4684	0.4704	0.4725	0.4745
1 7/8	11/15/21	11/15/51	912810TB4	\$69.0	0.4478	0.4498	0.4518	0.4539	0.4560
2 1/4	02/15/22	02/15/52	912810TD0	\$63.0	0.4961	0.4980	0.4998	0.5017	0.5035
2 7/8	05/16/22	05/15/52	912810TG3	\$60.0	0.5787	0.5801	0.5816	0.5831	0.5847
3	08/15/22	08/15/52	912810TJ7	\$57.0	0.5941	0.5955	0.5969	0.5984	0.5998
4	11/15/22	11/15/52	912810TL2	\$57.0	0.7285	0.7293	0.7303	0.7312	0.7323
3 5/8	02/15/23	02/15/53	912810TN8	\$57.0	0.6764	0.6776	0.6786	0.6798	0.6808
3 5/8	05/15/23	05/15/53	912810TR9	\$57.0	0.6754	0.6764	0.6776	0.6786	0.6798
4 1/8	08/15/23	08/15/53	912810TT5	\$63.0	0.7429	0.7438	0.7445	0.7455	0.7462
4 3/4	11/15/23	11/15/53	912810TV0	\$66.0	0.8281	0.8285	0.8292	0.8297	0.8303
4 1/4	02/15/24	02/15/54	912810TX6	\$47.0	0.7585	0.7593	0.7600	0.7609	0.7616

Image source: <https://www.cmegroup.com/trading/interest-rates/treasury-conversion-factors.html>

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How these “Micro Ultra Treasury” Futures Look on TWS

	LAST	FUT OI	CHANGE	
MTN Jun'24 @CBOT 	114'150	71	-0'040	-0.11%
MTN Sep'24 @CBOT	c114'300			
TN Jun18'24 @CBOT	114'125	2.05M	-0'065	-0.18%
TN Sep19'24 @CBOT	c114'300			
MWN Jun'24 @CBOT	128'150	350	-0'020	-0.05%
MWN Sep'24 @CBOT	c129'230			
UB Jun18'24 @CBOT	128'140	1.58M	-0'030	-0.07%
UB Sep19'24 @CBOT	c129'230	3		

Sep contracts are now more expensive than June contracts mostly because the 3-month interest rate between these two dates is higher than the interest these bonds would accrue over the same 3 months.

Image source: IBKR TWS, 28 March 2024 14:42 CET

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Sample TN buy order (try MTN when available)

Remember to put three digits after the ‘ in the limit price.

Order Confirmation

▼ Ultra 10-Year US Treasury Note

Financial Instrument	Ticker Action	Bid	Ask	Last
TN Jun18'24 @CBOT	Snapshot	114'110	114'115	114'110

Order Description

BUY 1

Order Type LMT Routing CBOT Time in Force DAY

Limit Price 114'080 Clearing IBKR

Messages

Amount		Balances (in USD)			
Amount		Current	Change	Post-trade*	
Amount	114,250 USD	Equity with Loan	332,586	-2	332,585
Commission (est.)	1.67 USD	Initial Margin	12,098	3,735	15,833
Total	114,251.67 USD	Maintenance Margin	9,678	2,988	12,666
		Position	0	1	1

*This is a current projection and is subject to change.
[Margin Requirements Per Contract](#)

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Image source: IBKR TWS, 28 March 2024 14:48 CET

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Sample strategies with Treasury Futures

- “Roll” permanent long position, capital efficient allocation
- “Roll” long term short, either for carry or to hedge floating loan
- Strategic trend following strategies
- Tactical long or short positions

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Rates and their impact on currencies

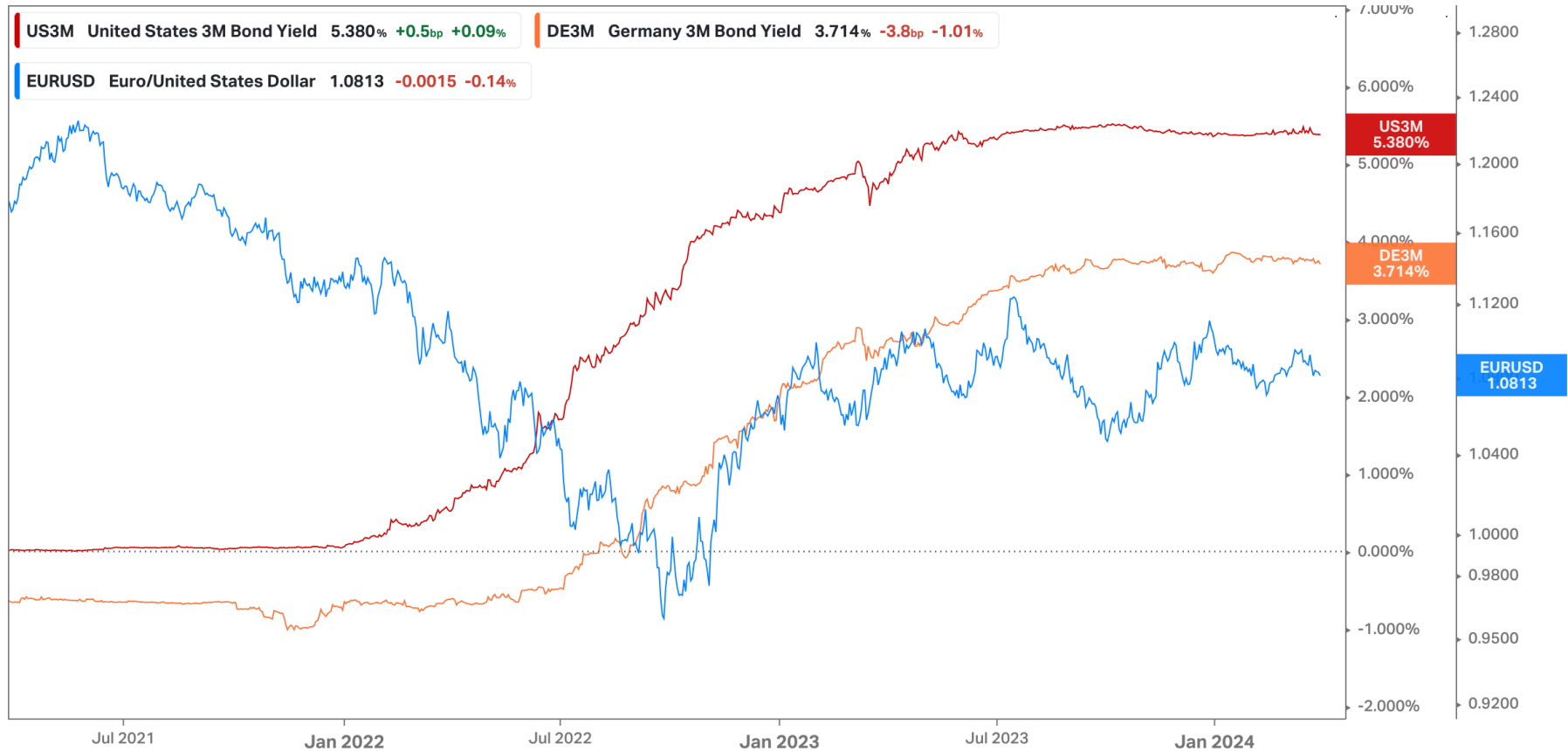


Image source: Koyfin, 28 March 2024 14:56 CET

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Just a few of the currency futures available

	COMPANY NAME		LAST	FUT OI
EUR Jun17'24 @CME	European Monetary Union Euro	◆	1.08485	649K
EUR Sep16'24 @CME	European Monetary Union Euro	◆	1.08920	2.57K
E7 Jun17'24 @CME	European Monetary Union Euro	◆	1.0849	7.42K
E7 Sep16'24 @CME	European Monetary Union Euro	◆	1.0888	18
JPY Jun17'24 @CME	Japanese yen	◆	0.0066930	292K
JPY Sep16'24 @CME	Japanese yen	◆	0.0067810	1.37K
J7 Jun17'24 @CME	Japanese yen	◆	0.006692	1.84K
J7 Sep16'24 @CME	Japanese yen	◆	0.006776	22

More available on <https://www.cmegroup.com/markets/fx.html#products>

Sep contracts are now more expensive than June contracts mostly because the 3-month USD interest rate between these two dates is higher than the EUR or JPY interest rate over the same 3 months.

Image source: IBKR TWS, 28 March 2024 15:00 CET

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Sample EUR/USD sell order (E7 is the e-mini)

Here, the e-minis are only half the size of the full FX future

Order Confirmation

European Monetary Union Euro

Financial Instrument	Ticker Action	Bid	Ask	Last
E7 Jun17'24 @CME	Snapshot	1.0848	1.0849	1.0848

Order Description

SELL 1

Order Type LMT Routing CME Time in Force DAY
 Limit Price 1.0900 Clearing IBKR

Messages

Amount		Balances (in USD)			
Amount	68,125 USD		<u>Current</u>	<u>Change</u>	<u>Post-trade*</u>
Commission (est.)	1.37 USD	Equity with Loan	332,427	-1	332,425
Total	68,123.63 USD	Initial Margin	12,108	1,740	13,848
		Maintenance Margin	9,686	1,392	11,079
		Position	0	-1	-1

*This is a current projection and is subject to change.
[Margin Requirements Per Contract](#)

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Image source: IBKR TWS, 28 March 2024 15:05 CET

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Sample strategies with Currency Futures

- Hedge foreign exposure, say to a foreign bond
- Carry trade between high vs low yielding currency
- Strategic trend following strategies
- Tactical long or short positions

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Questions?

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