

CONTENTS

.....

<i>Preface</i>	xiii
<i>About the author</i>	xix
1 BOND FUTURES CONTRACTS	1
1.1 Introduction	2
1.1.1 <i>Contract specifications</i>	4
1.2 Futures pricing	11
1.2.1 <i>Theoretical principle</i>	12
1.2.2 <i>Arbitrage-free futures pricing</i>	16
1.3 Hedging using bond futures	21
1.3.1 <i>Introduction</i>	21
1.3.2 <i>Hedging a bond portfolio</i>	26
1.3.3 <i>The margin process</i>	31
1.A Conversion factor for the long gilt future	34
Selected bibliography	38

2	THE GOVERNMENT BOND BASIS	39
2.1	An introduction to forward pricing	41
2.1.1	<i>Introduction</i>	41
2.1.2	<i>Illustrating the forward bond basis</i>	43
2.2	Forwards and futures valuation	46
2.2.1	<i>Introduction</i>	46
2.2.2	<i>Forwards</i>	47
2.2.3	<i>Futures</i>	49
2.2.4	<i>Forwards and futures</i>	50
2.2.5	<i>Relationship between forward and future price</i>	52
2.2.6	<i>The forward–spot parity</i>	54
2.2.7	<i>The basis and implied repo rate</i>	57
2.3	The bond basis: basic concepts	60
2.3.1	<i>Introduction</i>	60
2.3.2	<i>Futures contract specifications</i>	62
2.3.3	<i>The conversion factor</i>	67
2.3.4	<i>The bond basis</i>	75
2.3.5	<i>The net basis</i>	78
2.3.6	<i>The implied repo rate</i>	82
2.4	Selecting the cheapest-to-deliver bond	92

2.5	Trading the basis	94
2.5.1	<i>The basis position</i>	94
2.6	Exercises	97
	Selected bibliography	100
3	BASIS TRADING AND THE IMPLIED REPO RATE	103
3.1	Analysing the basis	104
3.1.1	<i>No-arbitrage futures price</i>	105
3.1.2	<i>Options embedded in bond futures contracts</i>	110
3.2	Bond delivery factors	112
3.2.1	<i>The cheapest-to-deliver</i>	112
3.2.2	<i>Selecting delivery time</i>	114
3.2.3	<i>Changes in CTD status</i>	117
3.A	General rules of the CTD bond	119
3.B	A general model of the CTD bond	121
	Selected bibliography	122
4	THE FUNDAMENTALS OF BASIS TRADING	123
4.1	Rates and spread history	124
4.1.1	<i>Net basis history</i>	124
4.1.2	<i>The implied repo rate</i>	128

4.2	Impact of the repo rate	129
4.2.1	<i>The repo rate</i>	130
4.2.2	<i>Short bond position squeeze</i>	134
4.3	Basis trading mechanics	136
4.3.1	<i>Using the conversion factor</i>	137
4.3.2	<i>Trading profit and loss</i>	138
4.4	Timing the basis trade using the IRR	139
4.4.1	<i>The implied repo rate (again)</i>	139
4.4.2	<i>The IRR across futures contracts: Bloomberg illustration</i>	143
	Selected bibliography	145

Appendices

A	REPO FINANCING AND THE CONCEPT OF THE 'SPECIAL'	147
A.1	Classic repo	150
A.2	Basket repo: Illustration using Malaysian government bonds	151
A.3	Special bonds in repo	155
B	RELATIVE VALUE ANALYSIS: BOND SPREADS	159
B.1	Swap spread and Treasury spread	161
B.2	Asset–swap spread	163



B.3 Z-Spread	165
B.4 Cash–CDS basis	169
References	173
C LIFFE LONG GILT DELIVERY HISTORY, MARCH 1996 TO JUNE 2001	175
<i>Glossary</i>	199
<i>List of abbreviations</i>	227
<i>Index</i>	229

