

P E R S P E C T I V E S

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Undressing the STRIPS market

STRIPS 101 - The Naked Truth

What are Treasury STRIPS?

- Treasury STRIPS (Separate Trading of Registered Interest and Principal of Securities) are Treasury securities (notes and bonds) that have been ‘stripped’ into their naked components. The ‘stripping’ process is conducted by dealers (typically financial institutions) on the CBES (Commercial Book Entry System).
 - For example, a 30 year US Treasury can be separated into the principal payment at maturity and each individual coupon payment at 6 month increments from now until maturity. The current 30 year is the 4.75% 5/15/55. If we take 100mm par and strip that bond naked, we will create 100mm 5/55 Principal STRIPS (“Ps”) and 2.375mm each of the coupon stream (“Coups”) starting on 11/15/25 and going until 5/15/55.
- STRIPS are backed by the full faith and credit of the US Government; hence, the default risk of STRIPS is the same as their underlying unstripped Treasury, thus attributing to a low-risk investment.

Why are STRIPS generally longer in duration? *Clothes can be such a drag!*

- Comparing a Principal STRIP with its corresponding unstripped Treasury, the Ps will generally have a higher duration despite having the same maturity. This is because of the zero-coupon nature of Ps, compared to unstripped Treasuries, which pay coupons semi-annually.
 - For instance, looking at long-end unstripped Treasuries and STRIPS maturing on 5/15/55, we find that there is a significant difference in modified duration: 15.7 years for the coupon bond vs. 29.2 years for the P (as of 6/30/25). The duration difference is driven by the fact that you receive some income from the unstripped Treasury every 6 months, which shortens its duration or payback period. The Principal STRIP receives no income (zero-coupon), which makes its duration roughly equal to its actual maturity.
- Given the zero coupon nature of Ps, they trade at a discount and gradually increase towards par at maturity. This allows an investor to increase duration exposure using less capital. In other words, an investor can get the same sensitivity to interest rate changes for their portfolio using fewer dollars or increase their duration risk using the same amount of dollars.

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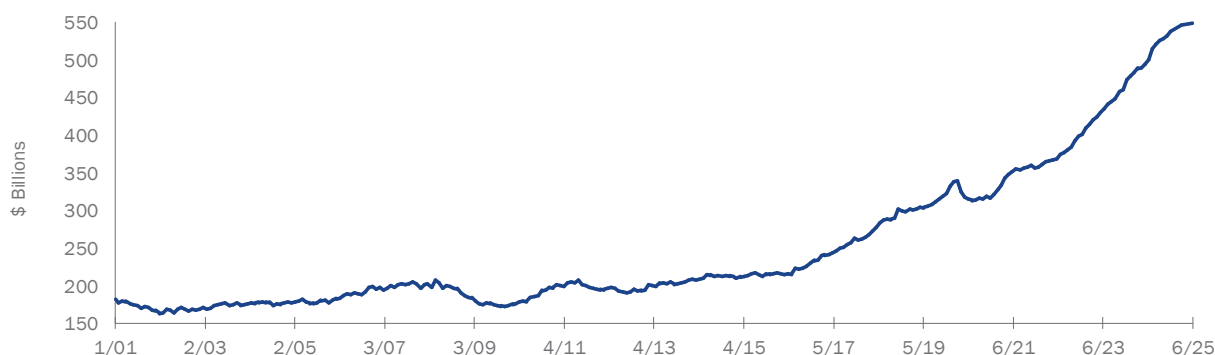
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What is the size of the market? *Size does matter!*

- The size of the total STRIPS market is ~\$549B market value (Exhibit 1), most of that is concentrated in long STRIPS with a maturity greater than 10 years.
- STRIPS have been in high demand with consistent net stripping since we moved into a higher rate environment in 2022.
- STRIPS outstanding at the end of 2021 was \$357B. Of course, market value was much higher back then given the 10 year yield was hovering around 1.5%!

Exhibit 1: STRIPS Outstanding



January 31, 2001 – June 30, 2025. The above time frame represents long term historical market cycles. Source: Office of the Chief Data Officer (OCDO) at the Bureau of the Fiscal Service (Fiscal Service), Department of the Treasury.

What are the most common indices used?

- Given STRIPS are a capital efficient (and unlevered) way to increase duration exposure and most of the bonds outstanding are long, the Bloomberg US STRIPS 10+ Year, 15+ Year, and 20+ Year Indices are most commonly used (Exhibit 2).
- We prefer the Bloomberg US STRIPS 20+ Year Index because it is large and the most liquid segment. In our view, it is the sweet spot in that the Index has enough bonds in the universe to provide relative value/alpha opportunities (79 holdings), while also getting sufficient duration (~26 years).

Exhibit 2:

| As of June 30, 2025 | | | | |
|------------------------------------|-------------------|----------------|-----------|--------------------|
| Benchmark | Market Value (MM) | Duration (yrs) | Yield (%) | Number of Holdings |
| Bloomberg US STRIPS 10+ Year Index | \$270,851 | 21.77 | 4.91 | 156 |
| Bloomberg US STRIPS 15+ Year Index | \$218,429 | 23.99 | 4.97 | 125 |
| Bloomberg US STRIPS 20+ Year Index | \$166,299 | 25.83 | 4.96 | 79 |
| Bloomberg US STRIPS 25+ Year Index | \$92,992 | 27.72 | 4.92 | 39 |

How can a plan use STRIPS? *How much exposure do you need?*

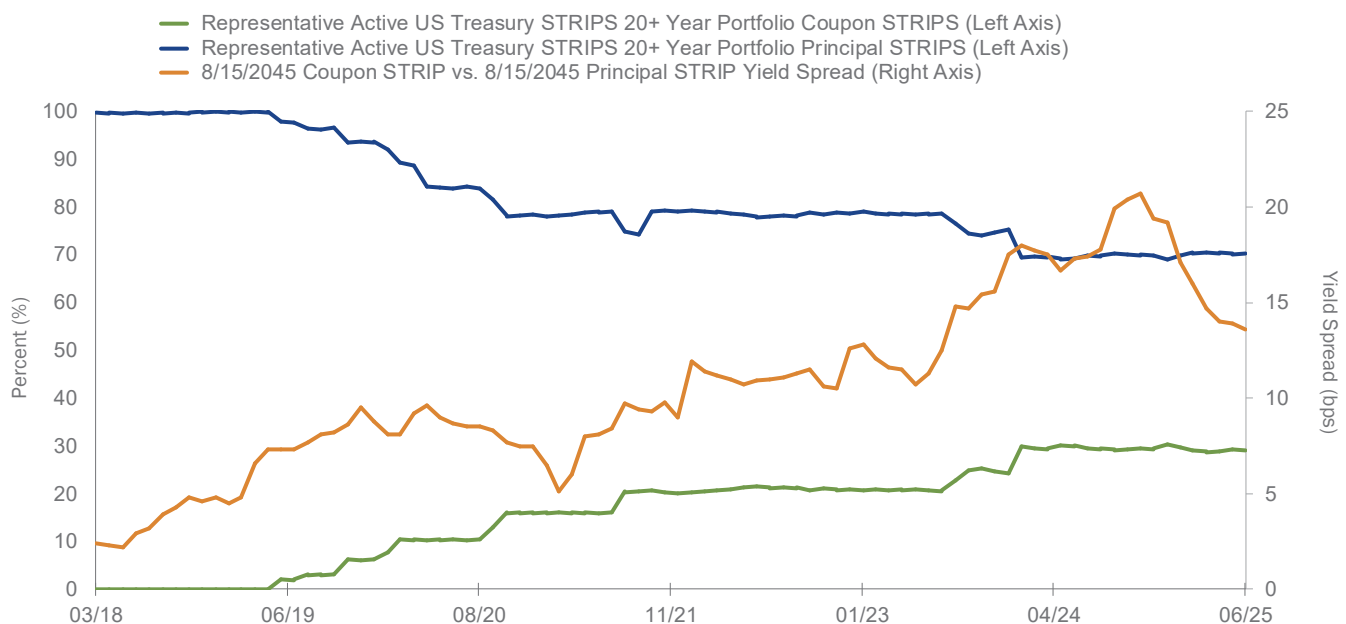
- STRIPS have historically provided significant diversification and helped with downside volatility in periods when equity returns were down the most. Additionally, a plan can increase duration exposure for the same amount of capital allocation.
- Liability-Driven Investing (LDI) clients often use STRIPS to increase their rates hedge when their allocation to fixed income is low.
- Other client types can also use STRIPS for a similar objective.
 - For example, if your benchmark is the Bloomberg US Aggregate Index, you can invest ~85% of your fixed income allocation in a two year duration instrument (like short high yield) and ~15% of your allocation in 20+ Year STRIPS with a ~26 year duration and mimic the Bloomberg US Aggregate Index's rate exposure.

The Case for Actively Managing STRIPS Portfolios - Avoid being burned, use sunblock!

Why active management?

- For what many would expect to be a highly liquid sibling of the \$36T US Treasury market, the STRIPS market can very easily get dislocated due to one off flows and dealers looking to reduce their balance sheet.
- Ps typically trade with 1-2bps of bid/offer. Coups typically trade with 3-5bps of bid/offer. Thus, transaction costs at start-up can be a hurdle, but not something that can't be overcome through active management.
- Liquidity in the STRIPS market is generally lower than in the past, as current financial regulations have lowered dealers' inventory. However, as liquidity has declined, mis-pricings and dislocations in the STRIPS market have increased, creating relative value opportunities.
 - For example, Ps trade in standard blocks of 100-200mm with the bid/offer cited above. Coups trade in standard blocks of 25-50mm. Given large stripping at the tip of the yield curve over the last few years and higher coupons on US Treasuries, there has been a large coupon creation which has cheapened Coups such that the spread between the same cash flow is 20-30bps in some parts of the curve (Exhibit 3).
- These factors create opportunities that may allow an investment manager to add alpha while taking very little risk. For example, a manager can move a position in Ps out the curve 3 months at a pick in yield and then soon thereafter move back into the original bond at a pick in yield. *Concentrated Positions + Larger Duration + Small Relative Value = Alpha Opportunities*

Exhibit 3:



February 28, 2015 – June 30, 2025. The information on this page is supplemental to the Jennison Active US Treasury STRIPS 20+ year Composite presentation. Please visit <https://www.jennison.com/gips-active-us-treasury-strips-20-year-composite> for the Active US Treasury STRIPS 20+ Year Composite presentation, which includes fee information and criteria for composite performance creation. Example is provided for illustrative purposes only and is based on a representative Jennison Active US Treasury STRIPS 20+ Year Portfolio. The representative portfolio was selected because it is in the institutional composite, and we believe the holdings, characteristics and risk profile are representative of the strategy. Representative portfolios are subject to change.

What differentiates an active manager?

- Jennison has actively traded STRIPS since the inception of the market in 1985. Over the last several years, we have seen increased client interest in STRIPS, due to their ability to hedge long term liabilities and extend duration in a capital efficient, low cost manner.
- Our bottom-up investment process seeks to add value through the active trading of STRIPS versus the more common passive strategy of many managers. We implement both yield curve and relative value strategies in our STRIPS portfolios.
- Holdings for our STRIPS only portfolios that are benchmarked against the Bloomberg US STRIPS 20+ Year Index would typically range between 5 and 20 securities versus the 70+ securities in the benchmark.
- Over the long term, we seek to generate half of our alpha from yield curve positioning, and the other half of our alpha from security selection in our active STRIPS portfolios.

End Notes

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All data provided is as of 06/30/2025.

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Market Definitions:

Coupon – the annual interest rate paid on a bond, expressed as a percentage of the face value and paid from issue date until maturity. Coupons are usually referred to in terms of the coupon rate, which is the sum of coupons paid in a year divided by the face value of the bond in question.

Duration – a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

Maturity – the date on which the life of a transaction or financial instrument ends, after which it must either be renewed or it will cease to exist. The term is most commonly used in relation to bonds but is also used for deposits, currencies, interest rate and commodity swaps, options, loans, and other transactions.

Option Adjusted Spread (OAS) – the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option.

Yield – a general term that relates to the return on the capital you invest in a bond.

Benchmark Definitions:

Bloomberg US Aggregate Bond Index includes securities that are US domestic, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg US STRIPS 10+ Year Index includes US Treasury Principal and Coupon STRIPS with a maturity of 10 years or more.

Bloomberg US STRIPS 15+ Year Index includes US Treasury Principal and Coupon STRIPS with a maturity of 15 years or more.

Bloomberg US STRIPS 20+ Year Index includes US Treasury Principal and Coupon STRIPS with a maturity of 20 years or more.

Bloomberg US STRIPS 25+ Year Index includes US Treasury Principal and Coupon STRIPS with a maturity of 25 years or more.

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