Bloomberg.com

Print

Treasuries Advance After Yields Rise More Than Growth Forecasts

Aug. 4 (Bloomberg) -- U.S. Treasuries rose in New York trading as investors said a surge in yields since mid-June overstated prospects for faster growth and higher inflation.

Ten-year note yields at around 4.5 percent are ``not unattractive in an economy that's growing slowly,'' said Mark Mahoney, head of interest-rate strategy at UBS Securities LLC in Stamford, Connecticut, one of 22 firms that deal directly with the Federal Reserve.

Yields declined even as the government planned to sell a record $60 billion in new notes this week to finance a widening budget deficit. The five- and 10-year notes may carry the highest coupons in a year.

The 3 5/8 percent note due in May 2013 rose 3/4, or $7.50 per $1,000 face amount, to 94 25/32 at 5:04 p.m. in New York, according to Cantor Fitzgerald LP. Its yield fell 11 basis points to 4.28 percent. A basis point is 0.01 percentage point.

The 10-year note's yield rose more than 1.5 percentage points to 4.59 percent on Friday from a 45-year low of 3.07 percent in June. It may decline to 4 percent in coming weeks, Mahoney said.

``There's a fair amount of income available'' after the surge in yields, said Ashok Bhatia, who helps manage $25 billion at Strong Capital Management Inc. in Menomonee Falls, Wisconsin.

Corporate bonds and Treasuries due in two to five years offer the most value, Bhatia said. The five-year note yields 3.10 percent, up about 110 basis points from a low of 2 percent in June. The two-year note yields 1.68 percent, up about 62 basis points from its June low.

At those levels, the notes will reward investors even if the Federal Reserve raises its benchmark interest rate in response to faster economic growth, Bhatia said. The Fed's rate, which determines how much institutional investors pay to borrow funds to invest in Treasury notes, stands at 1 percent, a 45-year low.

July Rout

The 10-year Treasury note had its biggest monthly loss since 1984 in July as investors became convinced low interest rates, tax cuts and a decline in the value of the dollar during the past year would stoke the economy and reverse an 18-month decline in the rate of inflation.

Comments by Fed policy makers helped fuel the advance. Fed Chairman Alan Greenspan on July 15 said the central bank ``stands prepared to maintain a highly accommodative stance of policy for as long as needed to promote satisfactory economic performance.''

Yields rose to levels that overestimate how quickly the economy will recover, said James Caron, a bond strategist at Merrill Lynch & Co., one of 22 firms that deal directly with the Fed.

Merrill Recommendation

``We continue not to add jobs, capital expenditures remain low and actual gross domestic product is falling short of potential GDP,'' he said. ``All those things should be a drag on the economy.''

Richard Bernstein, Merrill's chief U.S. strategist, said in a note to clients he may raise his recommended allocation to bonds from 45 percent, already the highest among 15 strategists surveyed weekly by Bloomberg News.

After reaching 4.59 percent, the 10-year note yield declined Friday after a government report showed U.S. payrolls shrank for the sixth month in a row in July. The employment report ``should've done a lot more for the market than it did,'' UBS's Mahoney said.

A two-year note yield almost 100 basis points higher than the Fed's benchmark ``is generous in an environment where the economy's still weak and the stock market's still suspect,'' said Bill Strazzullo, a strategist at State Street Corp. in Boston, the world's largest custodian of investor assets.

The note's yield may decline to about 1.6 percent in coming weeks, Strazzullo said.

Rate Expectations

The central bank cut its target rate for overnight loans between banks 13 times beginning in January 2001 to keep the economy growing amid a slump in spending by businesses. Interest- rate futures show traders expect the rate to rise during the first half of next year.

Traders today pared expectations the Fed will raise interest rates. The yield on the June 2004 eurodollar futures contract, an indication of expectations for a three-month lending rate that has averaged 24 basis points higher than the Fed's benchmark over the past 10 year, declined 11.5 basis points to 1.885 percent.

Still, many investors are reluctant to buy Treasuries before this week's sales of new notes.

Auction

To finance a budget deficit bond-trading firms on average expect to widen to a record $432 billion in the fiscal year ending Sept. 30, the Treasury will auction $24 billion in three-year notes tomorrow, $18 billion in five-year securities Wednesday and $18 billion in 10-year debt Thursday. The total tops the record $58 billion of last quarter.

``The fact that you've got $60 billion of supply that needs to be auctioned certainly doesn't help matters,'' said Thomas Girard, who helps manage about $6.5 billion of bonds at Weiss, Peck & Greer LLC in New York. ``There's definitely been some blood shed in fixed-income markets and people are skeptical.''

Gains in Treasuries also may be limited by fear of suffering additional losses, which may keep investors from buying until they are convinced prices have stopped declining, said Peter McTeague, Treasury market strategist at RBS Greenwich Capital Markets Inc. in Greenwich, Connecticut.

``People believe there's value in the market, but they're scared by the price action,'' he said.

Optimism about U.S. debt prices is at its highest since May, a sign the rout in Treasuries may be ending, a survey of investors by Ried, Thunberg & Co. showed.

Sentiment

Reid Thunberg's index, which measures sentiment toward the most actively traded government 10-year note, rose to 53 on Friday from 45 the previous week. A number above 50 indicates investors expect Treasuries to rise in price and fall in yield, by September. The 55 international investors polled manage a combined $2.05 trillion.

Investors surveyed by Westport, Connecticut-based Ried Thunberg increased their allocation of government bonds to 24 percent from 22 percent in the previous week, which was the lowest since June 2001, the survey found.

Last Updated: August 4, 2003 17:15 EDT

Print