

Markets

Government Bonds go boom, Yields go bust.

This week the Treasury priced their 3 month bills to yield a non-existent .004% (that's 4 thousandths of one percent) equating to practically nothing. It's interesting from the perspective of the advisory community, since this is a rare phenomenon.

What are the markets saying? Are they telling us that things have gotten so bad and wrong that the government can pay literally nothing, and still have substantial bidders to purchase their bonds?

Treasury bills work through a discounted purchase mechanism. Meaning, treasury bills are purchased at a discount to their face value. They are sold with 3-month maturities, and are priced to yield, generally, a small amount of interest for the purchaser. If a purchaser wants to own a t-bill yielding an annual rate of 4%, they would purchase a 3-month t-bill at 99% of face value. They would receive their additional 1% return by holding the bill to its maturity returning a full 100% to the investor. Why only 1% for the investor, and not the 4% that has been quoted? The 4% rate is for a full year, and since t-bills are only issued with 3-month maturities, they quote an annual yield, and not just the yield realized by the investor.

Now that you understand Treasury bills, why would anyone essentially receive *nothing* (also known as 'zero' or 'nada') in terms of interest by allowing the United States Government to hold their money? When things look ugly, economically speaking, treasury bonds, bills, and notes (i.e. the Treasury market) is generally known as a 'safe haven'. With all the turmoil in the world, you'll also notice that other investors - not just domestic investors - are also interested in holding our government's paper. When there is a substantial amount of demand for t-bills, the

prices rise. In this case, the prices have risen so far, that they have priced in a literal 'zero' rate of return for holders of t-bills. Why would they do this? In simple terms, it can be described by the overwhelming existence of fear in our financial system at the moment.

People are more willing at this point to accept a 'zero' return on their funds in lieu of NOT losing money. The person who buys a treasury security would prefer the iron-clad guarantees and backing of the U.S. Government to the potentially risky environment for their own bank, or for that matter, their own government bonds. Purchasers of our own government paper is, and continues to be, other governments and foreign investors looking to mitigate the risks affiliated with their own countries. We are viewed as the 'safest bet', in terms of the financial system at the moment. Treasury bills can also be priced with a negative yield as well. Imagine people paying more, or above face value, for t-bills. This would mean that they would rather accept losing 'less', by investing in the U.S. Government. It's crazy!

The demand for our paper is very high at the moment. When things settle down (and they eventually *will* settle down), yields will stabilize and bond prices will decline to normal levels. At this point, government bond prices have been abnormally high, and yields have been exceptionally low. Are we in a government bond 'bubble' of some sort? Things rarely continue in one direction unabated. We don't think this is any different.

On a simple level, bond prices that continually move higher will cause yields to consistently plummet. Bond prices have soared, and yields have certainly gone bust, for the time. Things will change, as they always do.

