

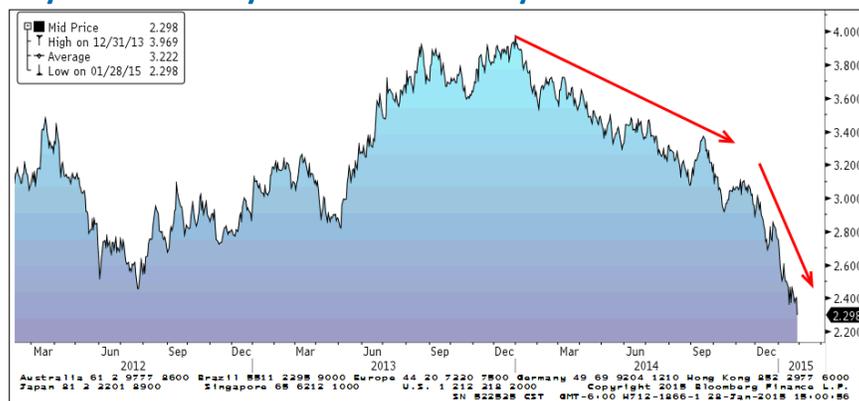
Another Day - Another Low Yield for the Long Bond

The US long-bond is on a mission...up 2 ½ pts today at a 2.30% yield. The prior cycle low for the 30yr US Treasury yield was in mid-2012 at 2.44%. We're 14bps lower now and falling. It probably helps to get a little perspective. When viewed on an inflation-adjusted basis, the bond yield is just 70bps above core CPI inflation. That compares with an average of 325bps since 1980. Now, to be clear...this is not the lowest we've seen for the "real" 30yr yield. In the late 1970s, the long-bond yield was actually negative on an inflation-adjusted basis. But that was because inflation was at soaring at double-digit rates and the bond market simply wasn't keeping up. Paul Volker solved that problem by breaking the back of inflation and bringing everything back into balance.

The situation today is quite different. Global growth has decelerated sharply and global inflation has disappeared. The US has the only healthy economy in the G12 and there is some question as to how sustainable US performance will be in the face of a very weak international economy. The closest comparable historical period is probably the years that followed the Great Depression. It was a long slow grind to get back to anything resembling normal. Japan has seen something similar more recently.

So are markets suggesting that we're in for a long, slow grinding period of low or no inflation with bond yields close to zero? Possibly. At the very least, current market behavior belies a fear of lower inflation and potential deflation. What's the advice for fixed income portfolio managers including banks? Don't sit on a pile of idle cash waiting for an imminent increase in rates. Use the rally to kick out bonds with high price risk if you can, but deploy excess liquidity prudently, and keep your balance sheet hitting on all cylinders. Anticipate, don't predict.

30yr U.S. Treasury Bond: 2012 - Today



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