U.S. Two-Year Yield Near Highest This Month as Asia Stocks Gain

By Wes Goodman

October, 20 2009

(Bloomberg) -- Treasuries were little changed, with two-year yields near the highest level this month, as a rally in Asian stocks fed demand for shares and corporate bonds.

A government report today will show U.S. housing starts rose in September to the most in 10 months, economists said, helping erode demand for the relative safety of Treasuries. A revival in the U.S. economy has helped corporate bonds return 9 percent in the past three months, versus 2.1 percent for Treasuries, based on indexes compiled by Merrill Lynch & Co.

"Yields on Treasuries are so low," said Marc Fovinci, head of fixed income at Ferguson Wellman Capital Management Inc.
in Portland, Oregon, which has $2.8 billion in assets. "We'd just as soon sit in corporates."

Two-year note yields rose one basis point to 0.97 percent as of 6:26 a.m. in London, according to data compiled by Bloomberg. The 1 percent security maturing in September 2011 traded at 100 1/32.

The yield rose to 0.99 percent yesterday, the most since Sept. 30. It has averaged 3.35 percent for the past decade.

Ten-year rates rose one basis point today to 3.40 percent.

Ferguson Wellman purchased bonds of JPMorgan Chase & Co., the second-biggest U.S. bank by assets, and Pfizer Inc., the world's largest drugmaker, in the past month, Fovinci said.

Merrill's Treasuries index yields 2.23 percent, versus 6 percent for the corporate index.

Stocks, Wholesale Prices

The MSCI Asia Pacific Index of regional shares advanced 1.1 percent, gaining for a second day. MSCI's World Index of shares returned 18 percent in the past three months.

Work began on 610,000 U.S. homes at an annual rate, up 2 percent from August, according to the median estimate of 76 economists surveyed by Bloomberg News before the Commerce Department reports the number today.

The report would show stabilization in the industry at the heart of the worst U.S. recession since the 1930s. The collapse of the U.S. property market in 2007 froze bond markets last year and triggered $1.65 trillion of writedowns and credit losses at banks and other financial institutions, according to data compiled by Bloomberg.

Figures from the Labor Department today will show wholesale prices were little changed in September, after jumping 1.7 percent a month earlier, according to the median of a separate Bloomberg survey.

Real Yields

Ten-year notes offer a so-called real yield, or what investors get after accounting for the cost of living, of 4.7 percent. The figure was as high as 5.95 percent in August, versus the five-year average of 1.43 percent.

Other yields indicate that the $11.6 trillion the Fed and the government have lent, spent or guaranteed to shore up the economy have made investors less sure that inflation will stay low than they were earlier in the year.

The difference between rates on 10-year notes and Treasury Inflation Protected Securities, or TIPS, which reflects the outlook among traders for consumer prices, widened to 2.04 percentage points from almost zero at the end of last year.

Demand for higher-yielding assets and record-low interest rates in the U.S. sent the dollar to the weakest level in 14 months against the euro.

"Given also the likelihood that the Federal Reserve will maintain its accommodative monetary stance, riskier assets will continue to fare well," said Mitsuru Saito, Tokyo-based chief economist at Tokai Tokyo Securities Co.

The dollar weakened as far as $1.4994 per euro, a level not seen since August 2008.

Fed Rates

Fed Chairman Ben S. Bernanke and his fellow policy makers cut the target rate for overnight loans between banks to a range of zero to 0.25 percent at the end of 2008. They will keep the target there until August, when central bankers will boost it to 0.5 percent, according to the median estimate of economists surveyed by Bloomberg from Oct. 1 to Oct. 8.

Fed efforts to cap borrowing costs brought down U.S. 30- year fixed mortgage rates to 5.19 percent from this year's high of 5.74 percent in June, according to Bankrate.com in North Palm Beach, Florida. The trend was interrupted this month, and the rate rose from 4.93 percent on Oct. 10, coinciding with an increase in benchmark 10-year Treasury yields.

Yields suggest banks are becoming more willing to lend. The difference between what banks and the Treasury pay to borrow money for three months, the so-called TED spread, was 20.7 basis points, near the four-year low of 16.3 basis points set Sept. 10. The spread narrowed from 1.35 percentage points at the end of 2008.

Junk Bonds

High-yield, high-risk company debt is still cheap even after this year's record 50 percent rally, according to Wall Street's top-ranked junk-bond strategists.

Job losses will slow in "coming months," while housing activity accelerates and consumer sentiment begins to improve, causing yields on junk bonds to narrow further relative to benchmark rates, JPMorgan Chase & Co. strategists led by Peter Acciavatti wrote in an Oct. 16 report.

Growth this quarter along with zero percent interest rates and diminished default risk offer investors "plenty of incentive" to buy such debt, they wrote.

High-yield bonds currently yield 758 basis points more than Treasuries, according to the report. That's 133 basis points more than the average spread implied by JPMorgan's 2010 default rate forecast of 4 percent, signaling spreads will continue to tighten, they wrote. Acciavatti's team has been ranked No. 1 among similar strategists in Institutional Investor magazine's annual poll for the past seven years.

Deutsche Bank AG, one of the 18 primary dealers that trade directly with the Fed, raised its forecast for 10-year yields at year-end to 3.75 percent from 3.5 percent, it said in a report Oct. 16.

"The bid for risky assets will remain robust, especially spread products and equities," according to the report by Mustafa Chowdhury and Marcus Huie, analysts for the bank in New York.

--With assistance from Bryan Keogh in London. Editors: Garfield Reynolds, Nate Hosoda

To contact the reporter on this story:
Wes Goodman in Singapore at +65-6212-1568 or wgoodman@bloomberg.net.

To contact the editor responsible for this story:
Rocky Swift at +81-3-3201-2078 or
rswift5@bloomberg.net.