

US Treasuries: why you should steer clear

Tom Dyson
MoneyWeek Nov 25, 2008

A long-term **Treasury bond** is like 30-year IOU written by the US government. When you buy one of these pieces of paper, you are lending the government \$100 until 2038.

Outside the [currency markets](#), the market for Treasury bonds is the deepest, most liquid market in the world.

I've written dozens of columns in [DailyWealth](#) over the last few years warning about the dangers of buying long-term Treasury bonds. The basic thesis is this: The government is printing an ocean of these bonds to pay for our deficits. Meanwhile, the demand for holding these bonds will fall, as other nations become less willing to finance our deficits.

I'm so sure these pieces of paper are worthless, a few months ago, I told my 12% Letter subscribers about an investment that profits from a fall in their prices... And I've bet on falling Treasury bond prices with my own money.

I want you to know, I've been wrong about this, I still am wrong about this, and I will probably be wrong about this for some time.

The federal government first issued bonds to finance the construction of the railroad in 1857. Right now, U.S. Treasury bonds are the most valuable they've ever been.

Just last week, the Treasury market moved to a new all-time high. Then it accelerated even higher. Thursday's move in bond prices was, I'm guessing, the largest "up day" in the history of Treasury bonds. The week as a whole was the strongest performance in Treasury bonds since the 1987 crash.

And right now, I see four reasons not to bet against Treasuries for a while:

1. Long bond prices have been in a bull market since 1982... That's a 26-year period of rising prices. They formed a peak in 2003, during the last deflationary scare, and then fell gradually for a couple of years. But in the last few months, they've risen back with new vigour. As I said, they made a new all-time high over the last couple days.

The rise of the Treasury bond market is probably the strongest trend in finance today. You can short it if you like, but in my mind, you'll end up like the swimmer who played chicken with the oil tanker.

2. The idea that Treasuries could be in a bull market is absolutely absurd. They are probably the single worst investment in the world. The US government is broke. It will never be able to pay them back.

Meanwhile, the best American companies – true profit machines like Coca-Cola ([NYSE:KO](#)) and ExxonMobil ([NYSE:XOM](#)) – trade at cash-flow yields in excess of 10%... And most investors won't touch them.

Having watched the markets for over two decades, I've come to appreciate that betting against the "absurd" is often a bad bet. The markets love being absurd. The rise of the Treasury bond market is a perfect example.

3. Treasuries are "acting well." The action is one indicator I often use to judge the future direction of a stock. If great news comes out and the stock falls, then I say it's acting badly. If the news is terrible but the stock rises, then it's acting well.

Long bonds are acting well. The news couldn't be worse. The Treasury is flooding the market with more bonds than at any time in its history. Asia is saying it doesn't want to hold so many. Plus, the recession will lower tax receipts at the IRS, the Treasury's main source of capital. Lots of supply, less demand, bad fundamentals... yet the market is running to a new all-time high. That's acting well, and it implies there's more strength to come for the Treasury bond market.

4. Finally, the credit bubble of the 20th century is arguably the greatest investment bubble in mankind's history. It popped this year. We could now see a severe deflation, despite the Fed's bailout efforts. In deflation, investors run to safety. They believe the Treasury bond market is the best place to hide in deflation.

Now, even if you agree with me that Treasury bonds could go higher, I don't recommend them. Here's how legendary investor Rick Rule puts the argument:

"Money will be attracted to the liquidity and transparency of the US long Treasury market. I think this will be the final bubble of my generation. Crowding into a 20-year bond in a depreciating currency when inflation sets in, and long rates inevitably rise, will be a religious experience for the victims, in my opinion."

Let me spell it out: If you are buying Treasuries today to make 3.5% a year, and rates rise to, say, double, the value of your bond will fall 40%. You're risking a catastrophic loss to make a small profit... like a bird that picks crumbs off the freeway.

This article was written by Tom Dyson, co-editor of the free daily investment newsletter [DailyWealth](#)