

THE RETURN OF UNCLE SAM'S 30-YEAR BOND

Nearly five years after offering its last issue of 30-year bonds to individual and institutional investors – causing some to warn of a bond shortage – the U.S. Treasury has returned to the market place with a \$14 billion issue of its longest maturity, perhaps leading you to ask yourself whether you should consider adding some to your portfolio.

The likely answer? Probably not.

To be sure, U.S. Treasury securities have the highest credit quality of all private and public sector U.S. debt issues, given that the Federal Government could always tax or borrow to repay principal and pay interest on time – a meaningful reassurance if you're lending your money to somebody for as long as 30 years. Moreover, being available in denominations of only \$1,000, they are easily affordable for most investors.

But, bearing 4.5 percent coupons, the new bonds provide little compensation in both absolute and relative terms for lending money to the Treasury – or anybody else – until February 2036:

- Given that yields of debt securities are lowest for those of the highest credit quality – and highest for those of the lowest quality, called “junk bonds” – they pay a bit less than high-quality corporate issues (and nearly 1 percentage point less than the 5-3/8 percent 30-year Treasury bonds issued in February and August 2001).
- Given that the Treasury's left hand (Internal Revenue Service) likes to take away at least some of what little the right hand (Bureau of Public Debt) gives, their income is reduced by federal income tax as much as income from corporate securities, even if, unlike corporates, it is exempt from state and local taxes.
- Given that yields on debt securities of comparable credit quality nowadays differ little from the shortest to the longest maturities, they pay Treasury bond owners locked in for 30 years about the same as Treasury bill owners who risk their money for only 90 days. As if to underscore the point, the \$21 billion of 3-year notes and \$13 billion of 10-year notes that were also auctioned at February's \$48 billion quarterly refunding also had identical coupon rates of 4.5 percent.

Because marketable bonds' prices – and thus their yields – fluctuate continually during the maturation process, it is quite possible that those who have to sell them before maturity may lose money on them despite the Treasury's high credit quality. (As if to underscore

that point, interest rates in general crept up slightly before they were a week old – and, thus, their prices drifted slightly lower.)

So why did the Treasury resume issuing 30-year bonds?

To “diversify (its) funding options and expand its investor base” ... “finance the government’s borrowing needs at the lowest cost over time” ... and “stabilize the average maturity of the public debt,” it said in statements.

That is to say:

- To meet demand that it expected after canvassing investors – and that it found at its February 9 auction – such as institutional investors, who worry less about their companies’ mortality than most individuals who regard 30-year investment horizons as a bit long.
- To lock in relatively low interest rates, which have prevailed in recent times, for the long-term part – albeit, a small part – of the public debt. By locking in low interest rates, Treasury will not be subject to unknown future borrowing costs when shorter-term debt must be rolled over.
- To address the average length of the marketable interest-bearing public debt held by private investors, which dropped from 6 years 1 month at the end of fiscal 2001 to 4 years 10 months at the end of fiscal 2005.
- Like individuals, who save toward long-term goals such as college tuition for children and retirement (but who may have more flexibility when taking risks), treasurers of institutions have to be sure that they are always able to meet liabilities when due – whether benefits to life insurance policyholders’ survivors or to pensioners.

Of \$4.1 trillion of the Treasury’s total marketable debt held by the public at the end of fiscal 2005, as much as \$500 billion was accounted for by long-term bonds. Short-and intermediate-term Treasury notes, ranging from 2 to 10 years, accounted for \$2.3 trillion (and about three-fourths of the increase in total publicly held marketable debt from \$2.9 trillion at the end of fiscal year 2001). Treasury bills and Treasury inflation-protected securities (TIPS) made up the rest.

Although the Treasury stopped selling new 30-year bonds in 2001, its 30-year issues had not disappeared, as some may have thought last August, when it announced that it would re-introduce them in semi-annual auctions beginning this month. Talk with your financial adviser today about whether 30-year bonds are right for your portfolio.

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