

A SHORTAGE OF GOVERNMENT ISSUES? WEB BUZZ 2010.06.28

The more the treasury issues additional government debt, the better market participants seem to like it. On June 22, the treasury sold \$40 billion of two-year notes. The yield investors received was 0.738%. The bid-to-cover ratio rose to 3.45 times. The yield was the lowest on record and demand was the best since October 2009. Market participants seem unable to get as much as they want. Do you remember that the consensus on Wall Street has been that, with all the new issues coming to market, interest rates were bound to go higher? So much for that idea. As we have mentioned time and time again, the demand for the safest asset in the world is and is going to be so strong that the new issue argument just doesn't hold water.

Macroeconomic conditions do matter. If the treasury needed to issue new securities in the face of inflationary conditions, interest rates would go sky high. As a matter of fact, things could get to such a point that no one would even show up to buy the securities. The old argument over inflation/deflation may be about to come to an end. As you know, we have been deflationists for lo these many years. Debt equals deflation when economic conditions become overburdening. Please keep in mind that deleveraging has just barely begun. High quality bonds are going much higher in price and much lower in yield regardless of the amount of new issues coming to the market. Conditions will change, and when they do, we must change our strategy. It won't happen soon; however, one must always watch closely.