Treasury Auction Demand Masks Ambivalence of U.S. Mutual Funds

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By Alexandra Scaggs and Daniel Kruger

(Bloomberg) -- U.S. mutual fund managers are winning an increasingly larger amount of shorter-term Treasuries at auctions this year. That doesn't mean they're bullish.

Demand from fund operators and institutional money managers, such as at Tuesday's $24 billion three-year note sale, may more likely reflect a lack of compelling alternatives in the global sovereign debt markets and reluctance to acquire longer- term maturities.

"It shows a more committed move towards neutral positioning," said Natan Magid, an analyst in New York at Bank of Montreal's BMO Capital Markets unit, one of the 22 primary dealers are obligated to bid at the auctions. "They've been burned too many times."

Treasuries yields are forecast to rise this year as signs of faster economic growth and rebounding inflation provide Federal Reserve policy makers with scope to raise interest rates. European Central Bank bond-buying has depressed sovereign yields within the currency-bloc nations, reducing attractive options.

The three-year notes were sold at a yield 1.104 percent, compared with an average forecast of 1.108 percent in a Bloomberg News survey of eight primary dealers.

Demand Sectors

Indirect bidders bought 51.4 percent of the sale, the most since April 2010. While indirect bids have been considered a measure of foreign demand, U.S. investors have become a bigger portion of that category in recent months, according to Wrightson ICAP.

"We've had a lot of very good auctions from the Treasury in recent months," said David Keeble, head of fixed-income strategy in New York at Credit Agricole SA. "Most have been bid by the domestic mutual funds, rather than the foreigners."

In January and February, domestic investors including mutual funds bought 37 percent of the three-year notes sold, according to Treasury allotment data. That was a step up from last year, when they bought just 24 percent of three-year notes, as forecasters widely expected Treasury yields to rise.

"We haven't seen evidence of people loading up on bets in one direction or another" on Treasuries, said Jim Collins, interest-rate strategist with Citigroup Inc., a primary dealer.

The yield on the benchmark 10-year Treasury note will rise to 2.58 percent by the end of the year, according to a Bloomberg News survey of economists. In January 2014, the median forecast for the year-end yield on the benchmark 10-year note was 2.80 percent. It ended the year at 2.17 percent.

Bearish sentiment may be counterbalanced by the ECB bond- buying program. Yields on 10-year German securities have dropped to a record, pushing the yield difference between 10-year Treasuries and bunds to the widest since 1989.

“There’s not enough supply out there,” BMO’s Magid said.

“These auctions give everyone a chance to get a share.”

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To contact the reporters on this story:

Alexandra Scaggs in New York at +1-212-617-0733 or ascaggs@bloomberg.net; Daniel Kruger in New York at +1-212-617-2986 or dkruger1@bloomberg.net To contact the editors responsible for this story:

Dave Liedtka at +1-212-617-8988 or

dliedtka@bloomberg.net

Paul Cox, Greg S