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Treasuries Snap 3-Day Gain; Debt Tops Stocks, Commodities in ’11
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By Anchalee Worrachate and Wes Goodman

Dec. 30 (Bloomberg) -- Treasuries snapped a three-day gain on speculation the rally that pushed U.S. government securities to their best year since 2008 will give way to losses in 2012 as the economy improves.

U.S. debt returned 9.6 percent in 2011 as of yesterday, according to Bank of America Merrill Lynch data, even after Standard & Poor’s cut the nation’s AAA rating on Aug. 5. German bunds also gained 9.6 percent, Japanese bonds advanced 2.1 percent and U.S. corporate debt rallied 6.6 percent. Treasuries, driven higher this year by demand for safety during the European debt crisis, are poised to beat stocks, commodities and the dollar for the year.

“Treasury yields at current levels are not adequately reflecting the U.S. growth outlook and inflation risk,” said David Schnautz, a fixed-income strategist at Commerzbank AG in London. “They are currently distorted by haven demand driven by the euro debt crisis. But at some point, the U.S. economic fundamentals will become a focus again.”

The 10-year yield was little changed today at 1.90 percent at 8:42 a.m. in London, according to Bloomberg Bond Trader prices. The 2 percent note due in November 2021 fell 1/32, or 31 cents per 1,000 face amount, to 100 27/32. Two-year yields were also little changed at 0.28 percent.

Commerzbank predict the 10-year yield will rise to 2 percent in the next three months, and reach 2.90 percent by the end of 2012.

Early Close

Treasuries are scheduled to close at 2 p.m. in New York and remain shut on Jan. 2 in observance of New Year’s Eve and New Year’s Day, according the Securities Industry and Financial Markets Association.

U.S. benchmark 10-year yields dropped to a record 1.67 percent on Sept. 23 as investors sought the relative safety of U.S. debt. Two years of summits have failed to contain a European debt crisis that has led to bailouts of Greece, Ireland and Portugal and now threatens Italy and Spain.

S&P downgraded the U.S. rating for the first time, criticizing lawmakers for failing to cut spending enough to reduce budget deficits that exceed $1 trillion a year.

“It was a really unusual year, one of the best,” said Kazuaki Oh’e, a debt salesman in Tokyo at CIBC World Markets Japan Inc., a unit of Canada’s fifth-largest lender. “Nobody believed Treasuries would be bought under 2 percent. Investors were forced to buy because of the European debt situation.”

Bill Sale

A four-week bill sale on Dec. 20 drew bids for a record
9.07 times the amount offered even though the securities yield negative 0.01 percent.

Treasuries beat German bonds even after volatility is taken into account. Their so-called risk adjusted return is 1.87 percent, compared with 1.54 percent for bunds.

Bill Gross, who runs the world’s biggest bond mutual fund at Pacific Investment Management Co., was among those caught off guard by the rally.

Gross was betting against U.S. government debt earlier in the year in the $241 billion Total Return Fund. Treasury debt comprised 23 percent of holdings as of Nov. 30, according to the Newport Beach, California-based company's website.

The fund has returned 3.7 percent in 2011, underperforming 70 percent of its competitors, according to data compiled by Bloomberg.

The median estimate of 70 economists and strategists surveyed by Bloomberg in early January was for 10-year yields to end this year at 3.75 percent.

Best Assets

U.S. government securities were some of the best assets to own in 2011.

Treasury Inflation Protected Securities returned 14 percent, the most since 2002, the Bank of America figures show.

An index of bonds around the world rallied 5.8 percent, based on the data.

The difference between yields on 10-year notes and Treasury Inflation Protected Securities, a gauge of trader expectations for consumer prices over the life of the debt, was 1.97 percentage points. The average over the past decade is 2.13 percentage points.

Stocks have lost 6.8 percent this year after accounting for reinvested dividends, based on the MSCI All Country World Index.

The Dollar Index tracking the U.S. currency against six foreign-exchange counterparts rose 1.8 percent in 2011. The Standard & Poor's GSCI Total Return Index of commodities was little changed.

Growth in the world's biggest economy will quicken to 2.1 percent in 2012 from 1.8 percent in 2011, a Bloomberg survey of banks and securities companies shows. The pace of expansion will be 8.5 percent in China, 1.66 percent in Japan and 0.45 percent in Germany, based on the responses.

U.S. 10-year rates will advance to 2.67 percent by the end of 2012, according to a Bloomberg survey of banks and securities companies with the most recent forecasts given the heaviest weightings. An investor who buys the debt today and sells at the end of next year would face a 4 percent loss should the forecast prove accurate, according to data compiled by Bloomberg.

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