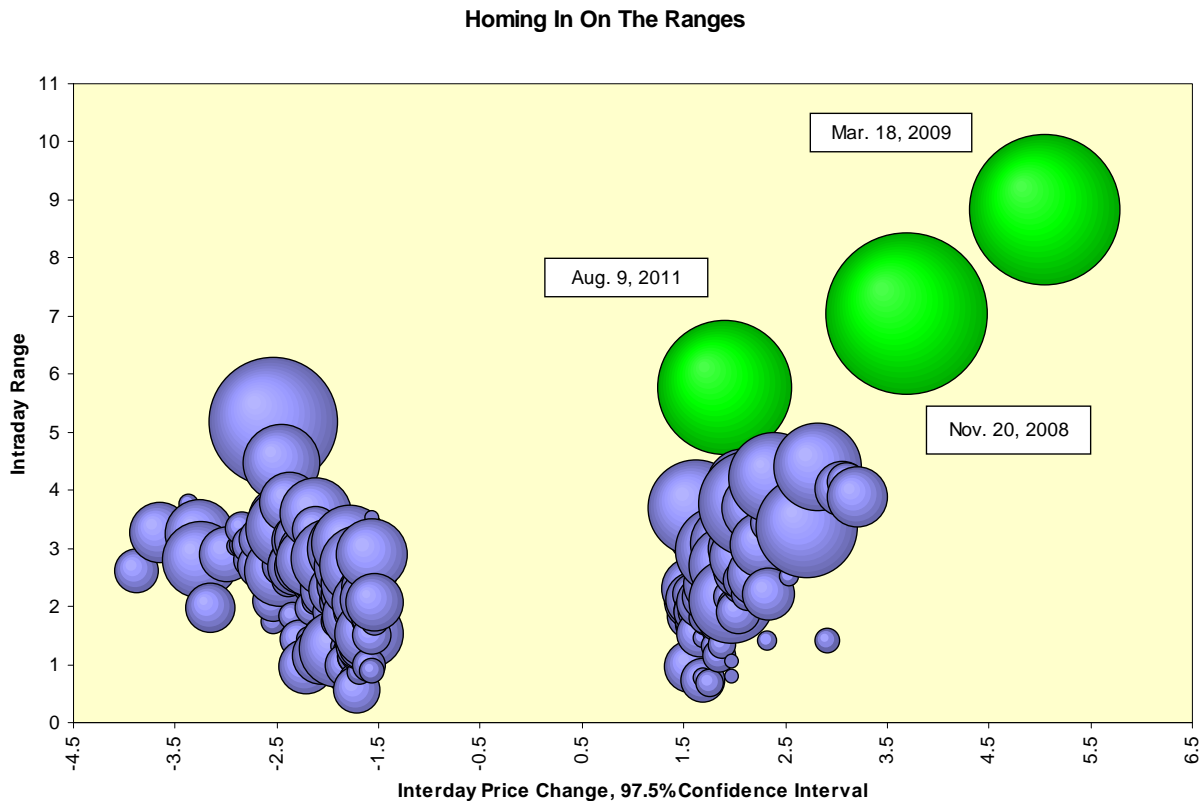


## Bond Futures' Hidden Selloff

We are so conditioned to looking at the 'change' on a quote screen we forget that intraday range can contain as much information as interday change. Last Tuesday's reaction in the thirty-year bond futures provides an interesting case in point. The thirty-year future has been around since 1977; ten-year futures began in 1982. The thirty-year was considered the benchmark long-term rate well into the late 1990s, but the contract declined in importance as Treasury issuance began to decline during the federal budget surplus years of the second Clinton administration.

I took the entire history of the future and extracted all instances of interday price changes lying outside of a 97.5% in-sample confidence interval. I then took the intraday range of those days and the change between the day's high or low against its close for up and down days, respectively. Those changes are depicted with the diameter of the bubbles below.



Three days, marked in green, really stand out from the crowd. They are the March 18, 2009, the day QE1 was announced, November 20, 2008, the date of one of the Citigroup bailouts and when Tim Geithner was nominated for his current Treasury post and last Tuesday's low-rates-forever announcement.

The high-to-close ranges on these days are enormous and if they were interday changes somehow would be amongst the largest selloffs in bond futures history; last Tuesday's high-close range, for example, would have been the 16<sup>th</sup> largest selloff.

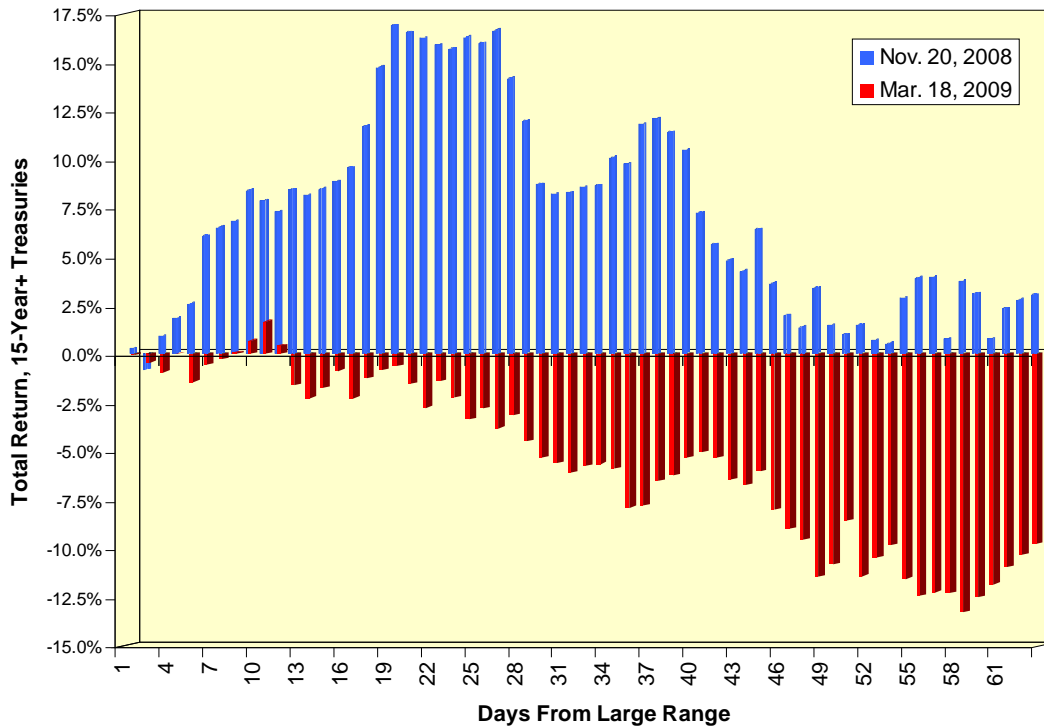
### Return Paths

Why are such days important? The simple reason is the market rallied very sharply and attracted sellers in so doing. A market unable to hold a lead is a market at a significant turning point. Alas, as markets evolve in tumultuous times, there are no hard-and-fast rules for what long-term Treasury securities will do after such an extreme.

Let's trace out the total returns of the Merrill Lynch 15-year+ Treasury index for the three trading months following the November 2008 and May 2009 extremes. Returns were positive after November 2008; this period included the adoption of zero interest rate policies in December 2008 and the year-end scramble to show safe (!) securities on the books. They were negative after QE1 as the market correctly feared the monetary stimulus would lead to a rally in

risky assets at the expense of Treasuries. I said at the time only the Federal Reserve could buy \$300 billion of something out of thin air and watch its price fall.

### Large Ranges' Mixed Return Paths



Where do we go from this third large range? As the yield curve has been squeezed like a toothpaste tube from the short end – the two-year Treasury is now yielding less than the upper end of the federal funds target range – we might see a little more buying in the long end as yield hogs assume duration risk.

However, this game is getting very close to the end. The duration of the current long bond, the 4.375% due May 15, 2041 is 17.13 as a write. This means you will lose 47 months of coupon income should yields rise back toward the 4.75% level seen just this past February. If you think lending Uncle Sam money at 3.75% for thirty years when the 30-year TIPS breakeven rate of 2.65% says your real return is 110 basis points before taxes is a good idea, go ahead, I will not stop you. But at this point, I think you are going to get much better real returns out of stocks.