

# REAL MEN

## TRADE THE LONG BOND

(From August 30, 2002 Pivotal Events)

### **Bond Future:**

In 1779, Samuel Johnson observed: "*Claret is the liquor for boys; port is for men; but he who aspires to be a hero must drink brandy.*"

These days, heroism is found in martinis and the long bond. Some twenty years ago, there was an article along the lines of "*Real Men Trade Long Bonds*". We would still go along with this and note that the ten-year, like Chardonnay, is for boys.

Most of the fashion in the shorter maturities is due to Europe, which merits some review. Over the past 100 years, Europe's political and consequent financial instability made it a rare accomplishment to have a liquid money market, let alone a liquid market for long-dated issues. Perhaps when Europe abandons its dreadful and endless experiment in socialism (Moscow on the Maastrich), a liquid market for long maturities will develop.

This could take a couple of decades when eventually the shorter maturities will be relegated to those who have just reached the drinking age. In the meantime, and reluctantly accommodating fashion, we will begin to cover the 10-year but will analyze this topping bond market at the long end.

### **Longer Term:**

Of course, we all know that the bigger bang from the trading dollar is obtained from the lowest coupon with the longest maturity. In this regard, British Consols with a 3% coupon and perpetual term are ideal. We'll have to do some thinking about a perpetual "zero".

Canada used to have a 3% "Perp", but the "Federasts" repudiated their obligations by forced redemption. With a bureaucracy dedicated to lowering interest rates, having a 3% issue outstanding when the long yield was at 19% (1981) was just too embarrassing.

Financial turmoil could soon increase long rates, but the next bull market for long governments in the reserve currency could take the yield down to 3%. In which case, the Consols or the equivalent would be a macho performer.

### **Yield Curve:**

The curve from the bond to the bill continues to flatten from 380 bp in January to 338 bp today. A reversal to steepening has been possible after August and could be noticeable by the end of September.

**Credit Spreads:**

Some narrowing has been expected with a recovery in the stock market in August. Following the panic in July, junk, for example, has come in from 793 bp over treasuries to 767 bp on Wednesday. In September, spreads have been expected to resume widening and reach dislocating conditions around December.

**Postscript:**

(from September 27, 2002 Pivotal Events):

Our "*Real Men Trade The Long Bond*" article on August 30 reviewed the ancient rule that the biggest bang is obtained from the lowest coupon and longest maturity. In it, we wondered about the absurdity of a "perpetual zero" and mentioned that we would have to think about it.

We have - and it could be a description of a currency with no intrinsic or redemption value. This probably holds as well for the economic theories that go with a fiat currency.

**Bond Future:**

The price action fell into a familiar pattern and reversed. Yesterday's ChartWorks [September 26] noted that the decline measures to 105 - 107.

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