

Q&A

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Steve Rodosky Discusses the Return of 30-Year Treasury Bonds



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Mr. Rodosky is a portfolio manager focusing on U.S. Treasuries, agencies and futures. He has eleven years of investment experience and previously was associated with Merrill Lynch as vice president of institutional sales. Mr. Rodosky received his bachelor's degree in English from Villanova University and his master's degree in financial markets from Illinois Institute of Technology.

On February 9, the U.S. Treasury will issue new 30-year bonds for the first time since the maturity was discontinued in 2001. In the interview below, PIMCO Senior Vice President Steve Rodosky, a portfolio manager and expert on U.S. government and agency bonds, discusses the implications of the new 30-year bond supply.

Q: Why did the Treasury Department stop issuing 30-year bonds in 2001?

Rodosky: In the late 1990s and early in the 2000's, around the time the Treasury stopped issuing new 30-year bonds, the U.S. had a budget surplus that played a big role in the lack of a need for Treasury to keep issuing the longest-term debt. There was also a "preferred habitat" dynamic at work, where most of the demand for Treasuries, especially at auction time, was in shorter maturities. As a result, the Treasury saw the cost of issuing the 30-year debt as being prohibitive in terms of where 30-year bonds were being auctioned relative to prices in the market going into auction time.

Q: Why is Treasury now resuming issuance of 30-year bonds?

Rodosky: Treasury is resuming 30-year issuance for two main reasons. First, the budget landscape has deteriorated over time, so there have been more frequent and larger issuance patterns for all maturities. Second, pension shortfalls at a lot of companies have been getting more attention in the press and the dealer community has been clamoring that there is demand for longer-duration assets. So the Treasury responded to the assumed demand from the pension community, and reissuing 30-year bonds also fit what the Treasury needed to do to finance the budget deficit.

Q: Has the Treasury market already adjusted to the upcoming supply of new 30-year bonds?

Rodosky: I think the general level of interest rates has certainly priced in the additional supply. Interest rates overall have risen in the last few weeks, to the tune of 20 to 30 basis points, in preparation for this refunding auction coming up on Feb. 9.

Q: How will new 30-year Treasury supply affect the shape of the yield curve?

Rodosky: New 30-year supply will certainly increase yield curve volatility in the early going, but only time will tell what the long-term effect on the shape of the yield curve will be. The market will first need to see whether end users, those with pension liabilities, actually do show up, en masse and repeatedly, for these 30-year auctions. The market will also need to see whether these end users trade 30-year bonds actively in the secondary market. If pensions do show up regularly for 30-year bond auctions

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and if they are actively traded in the secondary market, that would tend to have a flattening bias to the curve over the long run, all else equal. But only time will tell.

Q: Will new 30-year Treasury supply have an effect on corporate bond spreads or other sectors of the bond market?

Rodosky: I don't think new 30-year Treasury supply will have any major implications for other spread products or siphon demand away from other asset classes, but there might be some technical factors that will modestly come into play. For example, long-term corporate bonds have long traded relative to an outstanding Treasury bond maturing in February 2031, but will now be priced and quoted relative to this new point which is five years longer. So you might see some mild effects in how spread product is quoted but I don't think 30-year Treasuries will draw demand away from other sectors.

Q: Does the return of 30-year Treasury bonds hold any implications for the global bond market?

Rodosky: There should be some demand for the new 30-year bonds from the international pension community, which is further along in reforming funding requirements than the U.S. pension community. So, for diversification's sake, you might see some international demand. Central banks may also allocate reserve money toward the 30-year Treasury bonds, but a lot of those institutions have guidelines that keep them inside of the 10-year part of the curve.

Q: Thanks, Steve.

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