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THEY JUST WANNA SELL YOU A BOND FUND

By William H. Gross | May 2, 2024

No not Pimco — or me (who's marketing an online compendium of 46 years of my Investment Outlooks for $9.99) No, I'm talking about investment managers touting bullish forecasts for 4.60% 10-year Treasuries. Pimco's not one of 'em nor am I. Reunited in spirit at least. But many managers are bullish on bonds.

Some background. Vanguard's Total Bond Market Index Fund has provided a negative .1% total return over the last 5 years — includes income plus percentage price change. Now, however, bond bulls cite 2-3% forward inflation and a Fed cut, two, or three to suggest 10-year yields move to 4% which would produce a 7%+ total return for the balance of 2024. Not gonna happen in my view.

This concept of "total return" was a phrase Pimco originated in the depths of the bond bear market in the early 1980's. Such commonsensical brilliance emanated from a 15%, 30-year Treasury yield and the observation that based on rock bottom durations of 6-7 years they could go to 17.5% before an investor would be in the red. Not slam dunk at the time but close. Thus, managers were able to reverse the past reality of "certificates of confiscation" for which they were known at the time and produce a "total return" that was positive. Worked for a long time, until the summer of 2020 when 10-year yields bottomed at 53 basis points and these "investments" came to resemble Sisyphus headed downhill — 2 steps down, one step back up in price. Because yields were near 0%, not 15%, and durations were now in the 20+ year category, total return was dead.

Does this trend continue? Well not in the same magnitude and much depends on future inflation, the Fed's R* (real short rate target), and future supply. It's the future supply of Treasuries that I want to address. The outstanding balance of Treasuries has been increasing at a 10%+ annual rate for the past 18 months — a result of fiscal post-Covid deficits of 2-3 trillion dollars. At the end of 2023's fourth quarter there was nearly 30 trillion of outstanding public debt issued by the Federal government, growing at 10% a year.

Here's my argument — best outlined in my 2013 Investment Outlook "Credit Supernova" — of which I am most proud and available at a bargain rate of $9.99 for the bunch of them. The yield of outstanding total credit (Treasuries, corporates, mortgages, bank loans, etc.) is guesstimated at 5.5% and rising. Quite simply, (but subject to qualifications), the 77 trillion of total credit has to expand at this 5.5%+ rate in order to pay the bills — the 5.5% interest on what has been issued in the past. It has been doing that for some years now. Think of it as M in the Friedman concept MV=PT where V (velocity) is constant and PT = Nominal GDP. Credit, in other words, expands over time, to facilitate the growth of GDP.

Seems logical to me, but here's the rub. Recent growth in credit has primarily been a function of the growth of Treasury debt — 10% annually as previously mentioned. But business/household debt is now growing at 1-2% annually so the Treasury debt (a function of fiscal deficits) has needed to grow at 10% plus to produce credit growth of 5.5% and sustain nominal GDP growth of 5.5% as well.

Bottom line please Bill! The U.S. economy requires fiscal deficits and net increases in Treasury debt of 1-2 trillion or more annually in order for the economy to grow.

That's a lot of bonds. That's a good reason why 10-year Treasuries are at 4.60% instead of .5% in 2020. That's a good reason why the Fed holds FF at 5.25%+ instead of 0: They have to price money to satisfy the "vigilantes" now that QE is history and QT is underway. Look for 5% plus 10-year yields over the next 12 months — not 4.0%. Those that argue for lower rates have to counter the inexorable upward climb in Treasury supply and the likely Sisyphean decline in bond prices. Total Return is dead. Don't let them sell you a bond fund.