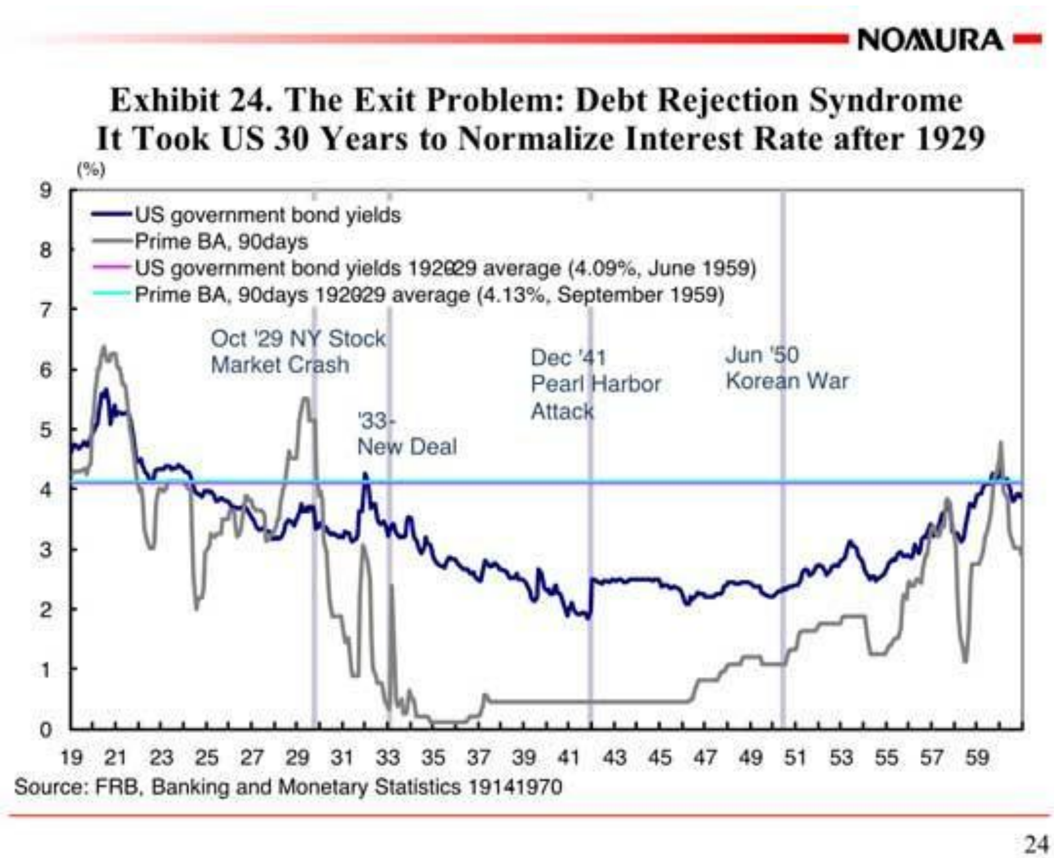
THE CASE AGAINST THE CONSENSUS
WEB BUZZ 2011.07.11

The most universal opinion (93%) concerning the 30-year long government yield is that (1) it can't go much lower as it's only 4.5%, therefore only 4.5 points from zero, which after all is much different than, say, 8%; and (2) past history shows that long rates start to move up sharply after a recovery is well underway. Both of the above observations are correct, but it is clear to us that they do not apply at this time. At some point they will, but we are not experiencing a normal type of economic cycle. Folks, we are having a balance sheet recession, which is a whole different kettle of fish. The last one was the infamous 1930s. Please note the chart below. Low long-term interest rates lasted for 17 years. This answers point number two above.



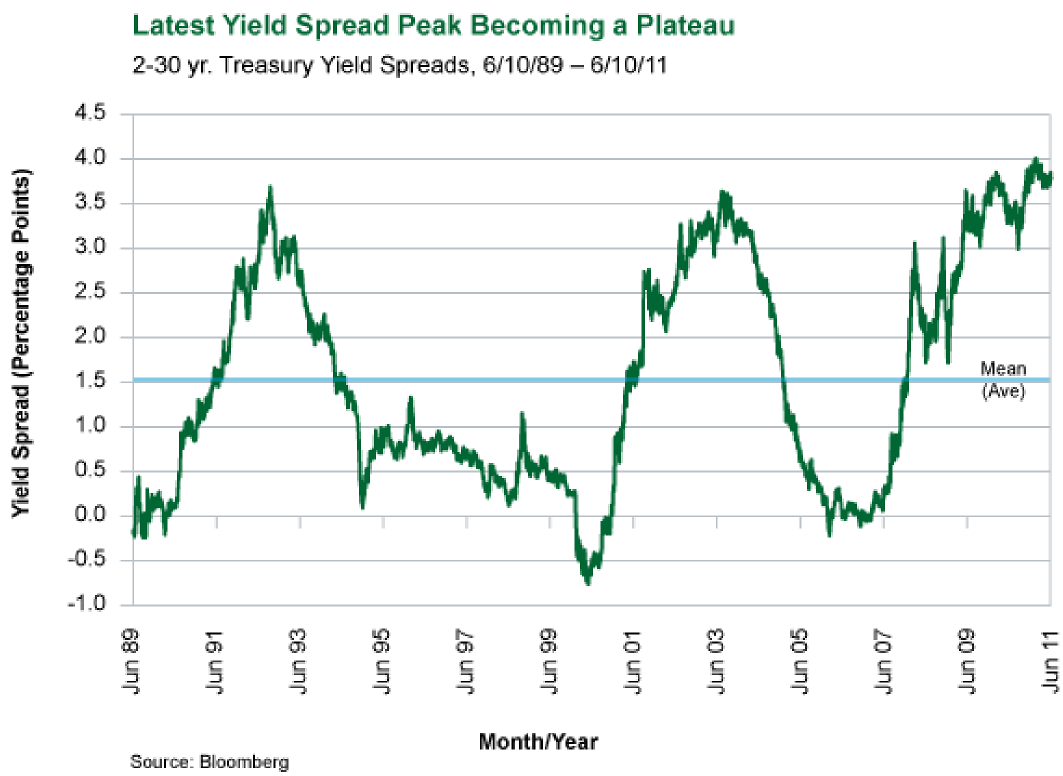
Adapted from businessinsider.com

Now concerning point one. Let's talk a little mathematics. The market value of a bond is the sum of the present value of a stream of income plus the amount certain at maturity. Note the difference between a move in interest rates on a 30-year bond from 4.5% to 2.5% as opposed to a move from 8.5% to 6.5%, the same size of downward move:

Interest Rate Move	Market Value % Increase
4.5% to 2.5%	42%
8.5% to 6.5%	26%

As we buy long governments for capital gains even more than for yield, this makes one heck of a difference.

The two objections mentioned above are therefore not valid. The nail in the coffin, as far as we are concerned, is the next chart.



Adapted from americancenturyblog.com

The spread between the 2-year government and 30-year government is at a 13 year high. The value is astounding at this point in time. The market consensus has given us a rare opportunity.