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A Simple Way to Cash In on Higher Yields

2-year Treasury notes are attractively priced at the moment

Nobody likes to catch falling knives, as the old Wall Street saying goes. Except that with shorterterm bonds, at least you're wearing some protective gear.

Traders seem to be struggling to find the bottom for Treasuries. The past week saw yields on the 10-year note surge beyond previous high-water marks, first 5%, then 5.1% and even 5.2%. The move was also accompanied by a jump in bond volatility, which had still been subdued until the last few sessions. This is a sign that markets are becoming more jumpy.

However, unlike with stocks, bonds offer some cushion, even if investors get their market calls wrong. Investors get a coupon payment that helps offset the decline in value the bond might experience if market yields rise. In other words, even if a bond's price drops, it can still end up with a positive return.

Plus, if a bond is going to mature in less than a couple of years, that adds another layer of insulation. That is particularly the case for buyers who can be comfortable holding until maturity, rather than constantly checking on the price to see if it has risen or fallen.

Currently, 2-year Treasuries are yielding over 4.9%. That isn't much less than what the 10-year Treasury is paying at over 5.2%. Longer-term bonds have some additional yield built in for less quantifiable risks like long-term inflation or a surge in future issuance. Whether that is sufficient compensation can be very tough to think through.

Longer-term debts are more exposed to bigger concerns, such as the Federal Reserve's credibility or the U.S. deficit.

Buying those bonds "requires investors to have more conviction given the more significant risk profile involved," says Gennadiy Goldberg, head of U.S. rates strategy at TD Securities.

For shorter-term bonds, though, it is a somewhat simpler equation. One way to think about a bond is whether it is a better buy over its lifespan versus just rolling over cash in very short-term bills, which is what a money-market fund would be doing.

That, in turn, is effectively asking what the Fed's rate target will be during the bond's life. And right now, the 2-year Treasury is pricing in the risk of a more-aggressive series of interest-rate increases than what the Fed itself is currently contemplating.

Following the Fed's rate increase in September, the current target overnight rate is 3.75% to 4%. The Fed probably won't stop there, barring some surprisingly negative economic or inflation data. Fed officials themselves are currently forecasting only one additional increase this year.

Meanwhile, the interest-rate derivatives market is pricing in even more hikes in this cycle, expecting a so-called terminal 4.85% fedfunds rate by September 2027, according to TD's Goldberg. That is a bit below what the 2-year will pay you in yield right now.

Of course it is possible that the Fed could turn out to be even more hawkish than that. Markets weren't fully anticipating how aggressive the Fed's 2022 hiking cycle turned out to be. The AI-fueled economy might also just need that much of a jolt to slow it down.

The flip side, though, is that it might not take too many increases to put the brakes on the non-artificial- intelligence sectors of the economy, such as the housing market, or the part of the corporate lending market that borrows at floating rates. And all of that is before considering the political dimensions for the Fed of sharply increasing rates under President Trump.

But investors don't have to be macro analysts. Either way, the relatively high yield on two-year notes and their shorter lifespan mean that it would take something quite extreme to generate overall losses for investors.

If two-year yields rose by an additional 1 percentage point over a one-year horizon, and the bonds lost value, they would still generate a total return of almost 4% in that time, according to estimates by TD Securities.

Longer-term bonds would be more exposed in such a scenario. Ten-year Treasurys would have a return of roughly negative 2%, and 30-year bonds would lose about 8%, according to TD's estimates. Conversely, they can also gain more if yields started falling sharply.

Some investors might be willing to bet on the direction of rates. Others may want to let the market set their rate with a short-term instrument like a money-market fund. The Crane 100 Money Fund index is at a roughly 3.7% yield.

Just remember, the bigger the knives you are juggling, the more likely you are to hurt yourself.

— Note

—Telis Demos

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Yields Keep Rising Despite Fall in Oil

BY HEATHER GILLERS AND SAM GOLDFARB

The punishing selloff in bonds is driving Treasury yields to ever more eye-catching milestones, with the 30-year bond yield reaching a 24-year high.

The slide continued Tuesday despite a decline in oil prices, a key driver of bond yields since the start of the war in Iran. Higher energy costs have spurred concerns that the Federal Reserve will need to keep raising interest rates well into next year—though other factors have also played a part, including recent signs of a strengthening economy.

“We’ve seen the market really start to try to wrap its arms around how much higher do rates need to go for the Fed to achieve its goal,” said Rebecca Venter, senior fixed income client portfolio manager at Vanguard.

Treasury yields, which rise when bond prices fall, were buffeted by conflicting forces on Tuesday. An expected \$32 billion bond sale from **Paramount Skydance** to help fund its acquisition of **Warner Bros. Discovery** put upward pressure on longer-term yields, as investors cleared room in their portfolios for the new debt.

Short-term yields, meanwhile, were pushed lower by comments from New York Fed President John Williams suggesting that the central bank need not rush to continue raising interest rates after officials voted through the first rate increase in three years earlier this month.

The influential Fed official said in a speech that another rate increase “late this year” might be appropriate but that there “is no need for urgency” to raise rates.

The 30-year bond yield settled at 5.594%, according to Tradeweb, up from 5.561% Monday. Earlier, the yield had reached as high as 5.621%, surpassing a 2004 intraday peak to reach its highest level since June 2002.

The 10-year yield settled at 5.256%, also its highest 3 p.m. ET level since 2002—although the yield still hasn’t breached its 2007 intraday peak of 5.303%, a threshold more closely eyed on Wall Street.

Stock indexes fell slightly. The Dow Jones Industrial Average edged 0.3% lower. The S&P 500 slipped 0.2%, while the Nasdaq composite retreated 0.1%.

Higher interest rates weigh most heavily on sectors like housing and consumer products, said Ross Mayfield, investment strategist at Baird. Investors also pull back on dividend stocks like utilities when they can collect fatter returns on short-term Treasuries. What’s left, he said, is a more volatile stock market dependent on artificial intelligence for growth.

“It makes it more fragile, it makes it more sensitive to any chink in the AI story,” Mayfield said.

Middle East crude exports rebounded this month to their highest level since the Iran conflict began. Brent crude futures fell 2.6% to \$102.59 a barrel. But Mayfield said investors are finding it hard to have faith in even optimistic seeming developments

on the Iran conflict after so many false starts and shifting headlines.

Cboe Global Markets wrote in a research note last week that the correlation between U.S. benchmark oil prices and the 10-year Treasury yield has jumped to a 35-year high, only slightly below the record set at the beginning of the First Gulf War in 1990.

TUESDAY'S MARKETS

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Stocks slip as rising Treasury yields pressure the market

Translate

By Damian J. Troise and Alex Veiga
AP Business Writers

Stocks closed modestly lower on Wall Street Tuesday as another increase in long-term Treasury yields weighed on the market.

The S&P 500 slipped 0.2% after wavering between modest gains and losses for much of the day. The Dow Jones Industrial Average dropped 0.3%, and the Nasdaq composite fell 0.1%.

Major indexes shifted lower after a quiet morning as rising bond yields undercut much of the heavy lifting being done by several technology behemoths. Nvidia, the market's most influential stock, gave up an early gain and closed 0.7% lower. Broadcom rose 1.6%.

Stocks remain under pressure as oil prices swing sharply as the U.S. war with Iran drags on, helping to push Treasury yields to their highest levels in 24 years.

The price of Brent crude oil in the most actively traded part of the oil market fell 1.7% to settle at \$96.16 a barrel. It briefly climbed above \$100 on Monday before prices eased a bit, but it is still well above the roughly \$72 it cost before the U.S. and Israel attacked Iran in late February.

Mediators continued to work with the United States and Iran on reaching a deal to end the fighting and open the Strait of Hormuz. U.S. President Donald Trump over the weekend rejected an offer from Tehran to reopen the key waterway.

Energy stocks had some of the broadest losses. Exxon Mobil fell 0.7%.

Overall, rising oil prices have been fueling a jump in Treasury yields. Higher yields threaten to slow economic growth by making borrowing more expensive for individuals and businesses. They can also hurt prices for stocks, especially those seen as expensive, including many technology companies that have soared because of the frenzy around AI technology.

The yield on the 10-year Treasury rose to 5.25% from 5.24% late Monday. It reached 5.28% earlier Tuesday, touching its highest level since 2002, according to Tradeweb.

Shares of CarMax rose 4.7% after the used car dealership chain reported soaring second-quarter revenue and delivered profits that easily beat Wall Street expectations. The company also announced changes to its executive leadership.

Oura, the maker of wearable digital health accessories and jewelry, said Tuesday that it was postponing its initial public offering, despite strong demand, due to uncertainty in the IPO market.

All told, the S&P 500 fell 12.85 points to 7,670.84. The Dow dropped 131.59 points to 51,349.92, and the Nasdaq gave up 22.84 points to close at 26,797.54.

Markets in Europe ended mixed and markets in Asia closed mostly lower.

With only one day left in September, the S&P 500 is on pace for a slight monthly loss after posting a 2.6% gain in August. The benchmark index is up 12.1% so far this year.

Wall Street will see several big economic updates this week that could help investors and the Federal Reserve get a better sense of where inflation is headed and how households and businesses are dealing with high prices.

The latest update on the jobs market Tuesday showed that U.S. employers posted fewer job openings in August. The Labor Department's monthly report said they slid to 7.08 million openings, marking a drop from July and registering below what economists had forecast. It also showed that layoffs fell and fewer people are quitting their jobs.

The jobs market has been resilient even as stubbornly high inflation squeezes businesses and households. Wall Street will get a broader update on Friday, when the U.S. releases its monthly employment report for September.

Households have been facing higher prices on everything from gasoline to clothing as the U.S. war with Iran curtails oil shipments through the Strait of Hormuz. The latest update on consumer confidence from business group The Conference Board shows a slump in September. Consumer confidence dipped to its lowest level in 12 years.

"Americans feel jobs are more scarce and are pulling back on plans for homes, cars, and big-ticket purchases, emitting a warning sign for holiday spending even though layoffs data show employers aren't yet cutting workers to match the gloom," said Jeffrey Roach, chief economist for LPL Financial, in a research note.