2026-7-23

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The Long Bond Is Making People Nervous

If they handed out medals for wrongness, a U.S. government report 25 years ago would have won a spot on the podium.

The Congressional Budget Office in 2001 predicted such large future budget surpluses that it said all redeemable U.S. government debt could be paid off within five years. That year the Treasury Department stopped issuing its longest-dated borrowings, 30-year bonds, because what was the point?

Treasury reversed course five years later as deficits widened, yet those bonds remain an afterthought. They shouldn't be. Their real (inflation-adjusted) yield just hit its highest level since 2008. Note

The long bond isn't as closely followed as the 10-year note, which is important for things like mortgage rates. But it's in some ways more informative because its price is so sensitive to changing economic assumptions. The message it's sending lately isn't an encouraging one for Wall Street or for Washington.

Note

Bonds have something called duration— the weighted average time it takes to receive their cash flows. Stocks are similar, except those flows aren't known for sure in advance and stocks never mature. Today's hottest stocks have very long durations since they pay small or no dividends and dangle distant profits when they're expected to dominate AI or space or whatever.

Note Note

The upshot is that stocks' future cash flows can't be measured in isolation—they're compared with what you could earn risk-free from the government. Since long bonds have the closest duration to the S&P 500, their rising real yields raise the bar for stocks, all else being equal.

Note

Then there is what the 30-year bond yield is saying about Uncle Sam's finances. By themselves they don't raise federal interest costs much since most debt issued these days is short-term. They do reflect investors' creeping doubts about the government's future ability to pay, though. Note

It's unlikely that the U.S. or other developed countries also facing stress will default, but there are other ways to deal with unsustainable borrowings. One is letting inflation quickly erode their value. It's possible for governments to stall for five or 10 years and hope the next people elected will make tough decisions. Not for 30 years.

Investors' nervousness is actu-ally understated since there are eager buyers for long-term debt that help keep yields in check. Pension funds and insurers that need to match the durations of their liabilities with similar assets snap up the longest-dated bonds even when yields are absurdly low. Six years ago Austria sold a 100-year bond paying zero percent.

Distortions notwithstanding, long bonds are a useful litmus test for financial angst. Keep an eye on them.

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Spencer Jakab

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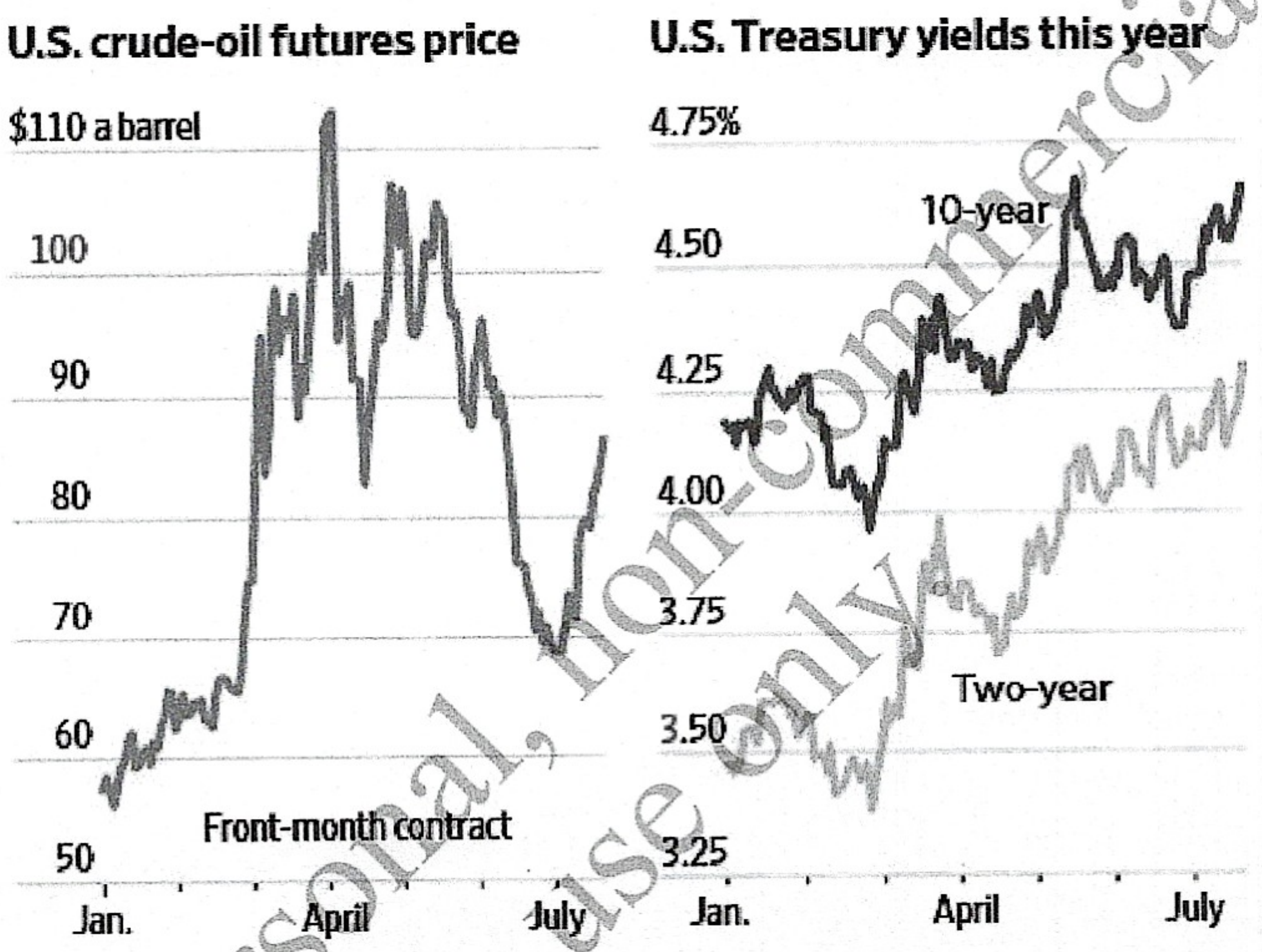

Sources: FactSet (oil price); Tradeweb (Treasury yield)