Being Mulish: I Buy Treasuries Direct

By Vineer Bhansali | October 20, 2022

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If you listen to the Fed, this is what you will hear: There will be no pivot! That is, they are not planning to lower rates any time soon come hell or high water. Each time there is a mini-hiccup in the global economy or the markets, many look for imminent signs of a pivot…but all we get is a string of Fed speakers who march out to say that they will keep interest rate hikes going for now, and there is no reason to worry about financial stability despite a cratering stock market and evaporating 401K balances.

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Despair no more! Believe it or not, the mulish persistence of inflation, and the even more mulish behavior of the Fed, opens up some very attractive investment opportunities for investors which have not been available for over a decade now. It just requires a little bit of point and click work by the investor on the internet.

But first, some background on the title of this note. The 8.2% inflation print of last week happened to coincide with the birth of a new family member in our animal household, Bruiser Woods. Bruiser is most likely a mule, if you couldn't tell from the accompanying photo –

hence the term “mulish”, as in stubborn as a mule. My wife rescued Bruiser’s mother, and the whereabouts or species of his father are unknown. But boy, is he a welcome member of our animal house!

Technically, mules are a blend between a donkey father (jack) and a horse mother (mare). Since the horse and the donkey are different species with horses having 64 chromosome and donkeys having but 62, mules have 63 chromosomes. In other words, they are a blend of a horse and a donkey, but unfortunately because of the odd number of chromosomes, genetic continuation becomes quite hard. Mules are very hard workers (when they want to), and can carry up to 20% of their body weight, a big responsibility.

Central bank policies right now are a hybrid of the inflationary horse and the financial instability donkey, and are likewise being tasked to carry a huge load. Policy makers have to optimize between unemployment (not too much), and inflation (not too high). The mulish attachment to the wrong “transitory” paradigm resulted in the current mulish persistence of inflation, which resulted in a massive increase in short term rates. So now we have a situation where very short term Treasury Bills are yielding more than any other maturity in the yield curve.

For example, as of today the 26 week Treasury Bill that will be auctioned on October 24th and which will mature on April 27 of 2023 is trading in the “when-issued” market at a yield of close to 4.5%. So it makes no sense to me to leave a lot of money in a bank deposit account where you are getting no return. Instead lend it to Uncle Sam for the next six months to pick up an extra 2.25%! For those who want to know, the annualized rate of return for one-week bills is about 2.5%, one month bills is 3.5%, and three month bills is almost 4%! (Source: Bloomberg) And if rates go higher, you can roll the cash at maturity at even higher yields.

By the way, this is why the banks are laughing all the way to the…bank, because they see that most investors have forgotten that deposits should get a market rate of interest, not zero-ish, which is what the banks are paying them (unless they tie up their money in a CD which comes with some credit risk). And this is part of the reason why banks "net interest income" is making records even though their business is facing unprecedented troubles ahead from an economic slowdown, rising mortgage rates, and yes, defaults. They take money from depositors at roughly 0%-ish, and lend to the Federal government, amongst others, at a nice little yield pickup – I cannot get into the details of the Fed Funds and repo markets here, but trust me there is a big yield pickup for the middleman – the overnight repo rate is already north of 3%. Highway robbery, if you ask me, because you can get more yield with less default and credit risk by lending to the government *directly.*

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Last week, my thirteen-year old son was a bit shocked to hear that he, through his Treasury Direct account, is actually lending to the United States Government. Most people know that the US government has trillions of debt that keep the country running, and it refinances this debt by issuing new debt. But most folks don't realize that the government today is actually paying a good market rate for your liquid cash. If you look at TIPS and I-bonds, they are making you whole even for inflation – contractually. Second, the government will need the good people here and overseas to lend it the cash, and to do so it will have to keep paying a good market rate of interest as it finances its debt. The US government can default, but the probability of it doing so before printing an unlimited amount of dollars to pay everyone is almost negligible. Certainly the US Treasury is more credit-worthy than your neighborhood bank.

Bankers will obviously not tell you to lend money directly to the US government, or in other words tell you to buy securities from the US government, because there are no fees attached to it. Similarly, fund complexes won't tell you to buy directly from the Treasury either, because then they also would not earn management fees. But it is as simple as opening an account at the Treasury Direct website, linking it to your bank account, and placing an order to purchase the securities once or on an ongoing basis. In my own experience, the site is still a bit clunky, but a huge improvement from a few years ago when I first discovered it.

So the last week when a good friend of mine asked me if I was bullish or bearish on the market, I simply said that at current yield levels, I am neither bullish nor bearish, just mulish with short-term Treasuries and TIPS that I purchase directly from the Federal government. If earning a little money instead of possibly losing a lot elsewhere makes me stubborn like Bruiser, then fine, go ahead and call me a mule.

Important Disclosures

Vineer Bhansali, Ph.D. is the Founder and Chief Investment Officer of LongTail Alpha, LLC, an SEC-registered investment adviser and a CFTC-registered CTA and CPO. Any opinions or views expressed by Dr. Bhansali are solely those of Dr. Bhansali and do not necessarily reflect the opinions or views of LongTail Alpha, LLC or any of its affiliates (collectively, "LongTail Alpha"), or any other associated persons of LongTail Alpha. You should not treat any opinion expressed by Dr. Bhansali as investment advice or as a recommendation to make an investment in any particular investment strategy or investment product. Dr. Bhansali's opinions and commentaries are based upon information he considers credible, but which may not constitute research by LongTail Alpha. Dr. Bhansali does not warrant the completeness or accuracy of the information upon which his opinions or commentaries are based.

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