

It's Time To Get Real

Historical Real Rates Of Return On 10-Yr. Treasury Note (T-Note)

Period	10-Yr. T-Note (Avg. Yield)	CPI Headline (Avg.)	Real Rate (Yield-CPI)
1965-1969	5.3%	3.4%	1.9%
1970-1974	6.8%	6.1%	0.7%
1975-1979	8.2%	8.1%	0.1%
1980-1984	12.4%	7.6%	4.8%
1985-1989	8.8%	3.6%	5.2%
1990-1994	7.3%	3.7%	3.6%
1995-1999	6.1%	2.4%	3.7%
2000-2004	4.8%	2.6%	2.2%
2005-2009	4.1%	2.6%	1.5%
2010-2014	2.5%	2.0%	0.5%

Source: Bloomberg.

View from the Observation Deck

1. As of the close of 4/13/16, the yield on the 10-Yr. T-Note was 1.77%. That is just one basis point above its 1.76% close on 12/31/12 (we will reference this again), according to Bloomberg.
2. This morning's release of the Consumer Price Index (CPI) headline rate showed that U.S. inflation stood at 0.9% in March, according to the Bureau of Labor Statistics.
3. That puts the current real rate of return on the 10-Yr. T-Note at 0.9%. The average real rate for the 50-year period ended 2014 (see chart) was 2.4%.
4. As has been the case since 2009, both the yield on the 10-Yr. T-Note and the level of the CPI headline rate have lingered well-below their historical norms.
5. In addition to producing an extremely low real rate of return, it sets up a potential dilemma. Should interest rates move higher, Treasury prices would most likely fall, as was the case in 2013.
6. From 12/31/12 through 12/31/13, the yield on the 10-Yr. T-Note rose from 1.76% to 3.03%, or an increase of 127 basis points.
7. In 2013, the BofA Merrill Lynch 7-10 Year Treasury Index declined by 5.82%, according to Bloomberg. The average price of the Treasuries that comprised the index declined by 8.41%.
8. One of the reasons why interest rates spiked so much in 2013, in our opinion, was concern that the Federal Reserve (Fed) might begin to raise short-term interest rates. It did not and interest rates retrenched considerably in 2014. The Fed, however, did raise interest rates on 12/16/15, and later commented that it may hike them another two or three times in 2016.

The chart and performance data referenced are for illustrative purposes only and not indicative of any actual investment. The BofA Merrill Lynch 7-10 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market.