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Treasuries Drop for 4th Month as Economy Fuels Fed Taper Views

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Treasuries fell for a fourth straight month, the longest losing streak in more than two years, as signs of a mending economy supported the case for the Federal Reserve to moderate monetary stimulus.

U.S. five- and seven-year note auctions this week attracted the least demand in four years as a report showed the economy expanded at a faster pace in the second quarter than previously estimated. A smaller trade deficit and gains in inventories overshadowed the effects of federal budget cutbacks, damping haven demand. A report Sept. 6 is forecast to show U.S. nonfarm payrolls rose more this month than last.

“It’s clear to the market that the Fed is committed to scaling back its purchases of Treasuries, and as such, we are seeing a continuation of the move out of the asset class at these levels,” said Christopher Sullivan, who oversees $2.1 billion as chief investment officer at United Nations Federal Credit Union in New York. “We’ve had unambiguously better GDP and a slow but steadily repairing labor market that has changed views on the path of the underlying economy. People have been more reluctant to hold Treasuries.”

The benchmark 10-year yield increased 21 basis points this month, or 0.21 percentage point, to 2.78 percent in New York, according to Bloomberg Bond Trader data. The price of the 2.5 percent note maturing in August 2023 was 97 17/32.

U.S. financial markets will be shut Sept. 2 for Labor Day.

Debt Returns

U.S. government securities lost 0.7 percent in August and 3.2 percent this year, according to the Bloomberg U.S. Treasury Bond Index. (BUSY) The four-month losing streak is the longest since the period ended March 2011.

Hedge-fund managers and other large speculators increased net-short position in 10-year note futures to the most since May 2012, according to U.S. Commodity Futures Trading Commission data compiled by Bloomberg. Speculative short positions, or bets prices will fall, outnumbered long positions by 110,825 contracts on the Chicago Board of Trade in the week ending Aug. 27.

Treasuries rallied this week, with benchmark 10-year yields falling three basis points, on speculation possible U.S. military action against Syria may spur refuge demand. President

Barack Obama said Syria's use of chemical weapons is a direct threat to U.S. and global security. He said yesterday he hasn't made a final decision on his response while "in no event" will it involve U.S. troops on the ground in Syria.

Momentum Play

Treasury 30-year bond momentum "is turning bullish" and the debt may be poised to pare the worst losses since 2009, according to Royal Bank of Scotland Group Plc. Weekly slow stochastics, a measure used to predict a security's movement based on how close its price is to its highest or lowest levels, are signaling stronger sentiment for the long bond after indicating weakness since May.

"The price momentum of the selloff has been losing thrust in recent weeks as the market has become oversold," said William O'Donnell, head U.S. government-bond strategist at RBS, one of 21 primary dealers that trade with the Federal Reserve.

Thirty-year bond yields rose for a fourth straight month, reaching 3.70 percent yesterday.

Second quarter gross domestic product growth at 2.5 percent topped the median forecast of 79 economists surveyed by Bloomberg that projected a 2.2 percent gain. U.S. payrolls rose 180,000 this month, up from 162,000 in July, and the jobless rate held at 7.4 percent, according to economists surveyed before the Labor Department reports the figures next week.

Fed Reaction

"Tapering is almost a done deal unless you get a real bad employment number in September," said Thomas Roth, senior Treasury trader in New York at Mitsubishi UFJ Securities USA Inc.

Minutes of the Fed's July FOMC meeting released on Aug. 21 showed policy makers were "broadly comfortable" with Chairman Ben S. Bernanke's plan to taper purchases this year if the economy strengthens, with a few saying a reduction may be needed soon.

The Fed will trim its monthly purchases of $85 billion at the next scheduled meeting Sept. 17-18, according to 65 percent of economists in a Bloomberg survey this month.

Investors have bid $2.87 for each dollar of the $1.443 trillion in U.S. government notes and bonds sold at auction this year, according to Treasury data compiled by Bloomberg. That's down from the record $3.15 for the $2.153 trillion sold at last year's offerings.

Auction Update

Demand was 2.43 times the amount of $29 billion seven-year notes for sale on Aug. 29, the lowest ratio since May 2009. The $35 billion five-year sale on Aug. 28 drew bids of $2.38 for every dollar sold in debt, the least since July 2009.

"The story in rates is about the Fed taper," said Adrian Miller, director of fixed-income strategies at GMP Securities LLC in New York. "Economic numbers are doing better and you have seen aggregate demand for five- and seven-year auctions cool."

The five-year note sale turned into additional issuance of seven-year notes sold in 2011, the first so-called unscheduled reopening since 2004. The Aug. 27 auction of $34 billion of two-year notes, the shortest maturity U.S. coupon debt, attracted the most demand since April.

Benchmark 10-year note yields will end 2013 at 2.73 percent according to the median in a Bloomberg News survey of 66 economists.