FT.com FINANCIAL TIMES

COMPANIES
UK

Close

The Short View

Print

By John Authers
Published: June 14 2007 03:00 | Last updated: June 14 2007 03:00

If you find bond mathematics difficult, you are not alone. The mere fact that the main measure of bond performance is the yield, which goes up when investors are losing money, and down when they are gaining, is befuddlingly counter-intuitive.

So take comfort from events yesterday. US Treasury prices had plummeted. In the space of five trading days, their yield moved from 4.9 to 5.3 per cent, matching the sharpest weekly move of the decade. The price of money in the US, and much of the world, was at its highest in five years as New York traders went home on Tuesday.

Yesterday morning saw May's US retail sales figures. They were much stronger than expected, showing that US consumers were not deterred from their normal buying habits either by historically high petrol prices, or by the nasty jolt to their wealth from declining house prices.

This was unambiguously bad for bonds (or good for yields). It meant the economy was stronger, and hence inflation risks were greater, than thought. That improved the case for the Federal Reserve to raise rates. And that should mean higher bond yields.

What happened? Yields ticked up instantly after the data were released. Then there was a wave of buying, and within half an hour, the 10-year yield dropped from 5.3 to below 5.2 per cent. A cue to sell bonds was treated as an opportunity to buy them.

At such times, animal spirits matter more than fundamentals. Analysts of trading patterns had predicted something like this could happen. Alan Rohrbach, a Chicago-based analyst, pointed out just before yesterday's bounce that a break through several psychological landmarks had come just as a long-term trend (for rising yields) was looking over-extended, and as bearish sentiment had become overwhelming.

These were reasons to buy. A fundamental reason to sell led to a better opportunity. Expect more such tests of logic before bond markets calm down.

Copyright The Financial Times Limited 2007

"FT" and "Financial Times" are trademarks of the Financial Times. Privacy policy | Terms
© Copyright The Financial Times Ltd 2007.