**Rattled Investors Paying a Premium for Longer-Term Treasurys**

Negative term premiums grow along with market fears

By

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The global scramble to snap up safer assets intensified Wednesday, sending the yield on the 10-year U.S. Treasury note below 2% and restoring an unusual situation in which investors willingly pay more for longer-term bonds than for an equivalent series of shorter-term securities.

This inversion, known as a negative term premium, stands on its head the long-standing risk-management practice of paying less for longer-term bonds, recognizing that longer-dated securities are more vulnerable to having their value eroded by inflation. Negative term premiums once were rare but have become more common since the financial crisis, reflecting among other things the soft growth, weak inflation and heavy debt loads occurring since 2008.

The latest bond rally reflects gathering concerns that an epic oil-price slump and persistently soft inflation are forecasting a broader downturn in the financial markets and global economy, prompting a flight to safer assets such as bonds issued by the U.S. and other rich-country governments.

“The term premium has tended to hit lows when fear is the dominant driver of investment,” said David Keeble, global head of interest-rates strategy at Crédit Agricole. “Investors are willing to protect as much of their net worth as possible, and Treasury bonds approximately provide this service.”

The recent purchases extend the latest winning streak for U.S. government bonds, whose prices rise as yields fall. The 10-year yield settled at 1.982% Wednesday, the lowest closing level since Oct. 14, and down from 2.273% at the end of 2015.

The term premium on the 10-year note hit negative-0.12% on Jan. 13, the lowest since April 2015, according to the latest data from the Federal Reserve Bank of New York. Two months ago, the reading was a positive 0.14%.

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Investors normally charge a positive term premium to lend cash longer term. But since the financial crisis, the 10-year note’s term premium has remained subdued.

Former Federal Reserve Chairman Ben Bernanke said in a blog post last year that the low reading of term premium is “consistent with the fact that, in a world of low inflation and accommodative monetary policy, as we have today, holding longer-term bonds may actually reduce the overall risk of investors’ portfolios.”

U.S.-based bond funds and exchange-traded funds targeting U.S. Treasury debt attracted $1.86 billion net cash for the week ended Jan. 13, according to data from fund tracker Lipper. It was the biggest weekly inflow since October and the fifth consecutive week of inflows.

Among buyers of Treasury bonds this month was Gary Pollack, who helps oversee $12 billion as head of fixed-income trading in New York at [Deutsche Bank](http://quotes.wsj.com/DB) AG’s private wealth-management unit. Mr. Pollack said he is increasingly concerned that the U.S. economy “is vulnerable to external shocks.”

A few months ago, Mr. Pollack saw near-zero odds of a recession in the U.S. But he now sees a 20% probability of another downturn in the U.S. economy later this year given the turmoil in global stocks, the continued decline in oil and a disappointing U.S. retail sales report.

To be sure, there appear to be factors in place now limiting price gains in the Treasury note. Unlike in years past, many foreign central banks are now selling Treasury debt in a bid to support their struggling economies or prevent a sharp fall of their local currencies. These central banks, led by those in China and Saudi Arabia, had been steady and big buyers as they recycled a large amount of dollar reserves accumulated via trade surpluses or oil revenues.

“Normally you would have seen one-way buying in Treasury bonds in a big stock selloff, but this time, selling from reserve managers has been an offsetting factor,’’ said Priya Misra, head of global rates strategy at TD Securities LLC.

Shyam Rajan, head of U.S. rates strategy research at Bank of America Merrill Lynch in New York, estimated that China sold $292 billion of U.S. Treasury debt in 2015, which concentrated on debt maturing in five years or less.

Some money managers say low term premium and yield levels make the bonds unappealing, warning that demand could quickly reverse if stocks and oil prices stabilize.

“It is bad idea to buy Treasury bonds” at current yield levels, said Luca Paolini, chief strategist at Pictet Asset Management, which has $150 billion in assets under management. He warned that pessimism over the growth outlook is overdone.

But Zhiwei Ren, managing director and portfolio manager at Penn Mutual Asset Management Inc., which has $20 billion in assets under management, said he bought long-term Treasury bonds earlier this month.

Mr. Ren said that owning safer assets makes him “sleep better in this risk-off environment.”

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