WHAT IS THE HIGHEST YIELDING TREASURY SECURITY?

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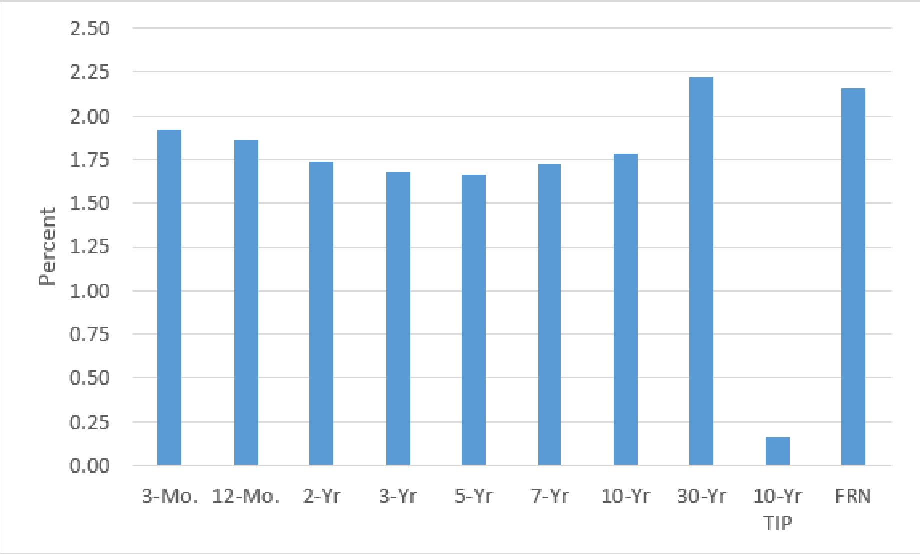
The rally in the US Treasury market has created a rather interesting investment backdrop. As you may have already heard, with yields coming down across the maturity spectrum, curves have either flattened, or have become inverted, leaving investors with some important decisions to make in their fixed income portfolios. Before I get into the investment aspect of the process, let's first take a look at how the Treasury's maturity lineup stands as of this writing.

Figure 1: US Treasury Yields



Source: Bloomberg as of 19 September 2019.

Historical performance is not an indication of future performance and any investments may go down in value.

The accompanying graph highlights the widely watched Treasury maturity spectrum, ranging from the 3-month bill on out to the 30-year bond. And for good measure, I threw in the 10-year TIP to go along with the floating rate note (FRN). This way investors can get an up-close look for themselves at the various yield disparities.

Without a doubt, some of the widest yield dispersion is occurring versus the two to ten-year part of the curve. The FRN yield is roughly 40 – 50 basis points (bp) above the levels that exist for that sector. The spread versus the 3-month bill is out over 20bp, and even compared to the 30-year bond, FRNs yield only 6bp less than this longer-dated maturity.

The most noteworthy differential exists versus Treasury Inflation-Protected Securities (TIPS). In this instance, the spread ballooned out about 200bp for both the five and ten year TIPS maturities. In fact, these TIPS yields were not too far above zero.

From an investment backdrop, I keep going back to the shape of the Treasury yield curve, and what are investors being compensated for. Given the flat/inverted nature of the curve, in my opinion, investors are not being rewarded for taking on too much duration risk. This is especially true in areas such as TIPs. While I know it may seem like a ‘stretch’ to think rates are going to go up again at this juncture, investors should still consider the risk/rewards of their fixed income positioning. Treasury yields leave little room for surprises. At present, excluding the long bond, United States Treasury FRNs are the highest yielding security in Treasury-land, with a duration of one week, providing investors with both income potential in a historically low rate environment, and also offering a hedge against ‘fixed’ coupon securities, especially if the Federal Reserve is not as aggressive cutting rates as the market currently anticipates.

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