AMERICAN YIELD QUESTS: US TREASURY AND CORPORATE RATES
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Well the first days are the hardest days, don't you worry any more,
'cause when life looks like Easy Street, there is danger at your door. "Uncle John's Band", a Grateful Dead song

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For several years, in response to the terrifying ongoing international economic crisis, the Federal Reserve Board, European Central Bank, and many other key central banks have played Santa Claus to the global economy in general and debtors (borrowers) in particular. Suppose marketplace stargazers scan the constellation of accommodative Fed policies. These include the blessings of ground level interest rates (Federal Funds) and three sparkling rounds of money printing. The Fed joyously promises to continue offering its bountiful gifts for quite some time! Not to be outdone, American and other politicians chattering and sometimes laboring in their workshops, engage in massive deficit spending designed to launch and preserve economic recovery.

The quest to keep Federal Funds and thus United States Treasury yields at or near the floor in practice has meant that UST returns relative to inflation across much of the yield curve have been negative or mediocre. Given the recent relative unattractiveness of UST, except for "flight to quality" (or official reserve) purposes, many financial all-stars and others have sought to boost their returns by owning more stocks or acquiring alternative "investment" vehicles such as commodities. The Fed's concerted campaign indeed has helped to restore nominal household net worth (balance sheets), particularly via soaring equity prices (S+P 500); the Fed also hopes to propel a rally in real estate marketplaces.

Other interest rate marketplaces such as corporate, municipal, and mortgage notes and bonds of course are extremely diverse. Their supply/demand variables do not duplicate those of the UST playground. Their yields of course soar or dive according to entangled economic and political phenomena. However, UST rates and thus Federal Reserve policies intertwine with and thus influence these marketplaces. Consequently, with UST rates having descended substantially from their peaks at the advent of the financial disaster, with UST now offering mediocre returns, many pilgrims seeking better (improved, higher) returns have gobbled up not only stocks, but also corporate and other debt.

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A sustained climb in UST and (or) other American interest rates might suggest an improving economic landscape. However, it might hint at ascending inflation. Or, UST and other rate jumps might reflect severe fiscal problems (witness the European periphery experience; US fiscal cliff issue). Deteriorating credit quality can force the given borrower to pay up to secure funding.

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In any event, the UST 10 year note established a major bottom several months ago, at 1.38 percent on 7/25/12. Note that on 12/12/12 the beneficent Federal Reserve not only reaffirmed its two percent long run inflation target, but also indicated it would tolerate inflation projections of 2.5pc for up to two years ahead. Ascending UST rates suggest that the US corporate realm likewise in general will have higher rates.

Take Moody's Baa index of bonds as a benchmark for US lower quality corporate bonds, yet nevertheless "investment grade". These include all industries, not only the industrial domain; the

bonds have an average maturity of thirty years (Federal Reserve, H.15 tables; monthly averages). This data extends back nearly 100 years, to 1919. See yield summits of 17.2 percent in 1982, 10.7pc in October 1990, 8.9pc in May 2000, and 9.2pc of November 2008. The average yield of the 11 month January-November 2012 span is just under five percent. This rivals the depth reached nearly 50 years ago, achieved for the years 1963 through 1965. The November 2012 monthly average of just over 4.5pc is the lowest since April 1957's 4.4pc; it equals about half the average of the May 2000 and November 2008 plateaus.

Based upon this Baa corporate signpost, US lower quality corporate bond rates have been creeping up lately. They probably established a very significant trough around 4.5 percent in November 2012, or will do so soon. Using daily data (and the extra decimal point) that bottom was 4.42 percent on 11/8/12 (12/18/12 close 4.76pc).

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In the US credit arena nowadays, a widening yield spread between lower quality corporate debt and UST might reflect that the hunt for better yields beyond the UST field probably has reached an end.

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