
Supply-demand imbalance to weigh on US yields: BlackRock

By Editor Test Tue, Feb 7, 2012

"The biggest dynamic is simply the lack of supply in fixed income," a BlackRock executive said. "We are seeing something we have not seen for at least 25 years."

U.S. Treasury yields will stay depressed for "a very long time," BlackRock's fixed income fundamental portfolios Chief Investment Officers, Rick Rieder, told *IPE.com* this week.

As the Fed begins to remove the liquidity it has injected into the economy [by selling mortgage-backed assets it purchased during the crisis], he said, it could trigger a flight to quality, possibly leading to lower Treasury yields.

But Rieder also warned against expectations for curve steepening, saying that even long-dated yields are unlikely to move very far.

"The biggest dynamic is simply the lack of supply in fixed income," he said. "We are seeing something we have not seen for at least 25 years."

A generation's worth of leveraging, which peaked at the height of the credit boom, created a huge supply of fixed income securities, he said. Between 2002 and 2007, there was \$1.5 trillion (€1.1trillion) of net fixed income supply and approximately another \$1 trillion of structured supply.

But, thanks to deleveraging, net debt issuance is set to turn negative in 2012, according Rieder, who cited estimates from Credit Suisse. "At the same time, demand will be growing, because populations are aging and longevity is extending at a faster rate than ever before," he told IPE.

"Every single developed country has a declining working-age ratio combined with credit-to-GDP levels of 100% or more. As the Japan situation has shown, that means less productivity, growth staying low, more dependence on fixed income and more need for yield."

BlackRock expects corporate DB plans to buy \$1.2 trillion in long U.S. Treasury bonds over the next decade. Insurance companies will need \$592 billion worth of high-quality bonds in 2012, even if they write no new business.

With net US Treasury supply reducing significantly in 2012 and supply from financial corporations, mortgage agencies and other sources of securitized debt turning negative, the only source of stable supply of bonds will be non-financial corporations.

"The only sector that isn't de-leveraging is business - so the only source of supply will be in the form of corporate credit," Rieder said.

To build diversified portfolios of fixed income in the face of low supply, he added, investors may have to

relax their credit-quality restraints and purchase high-yield and emerging market debt.

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