Why Buying Bonds is a Bad Idea

By The Mogambo Guru

11/16/10 Tampa, Florida – If there are two things that you can count on, it is that you have got to be pretty quick to get the last piece of pizza before I snag it, and that I am never remiss in telling people that buying bonds at these insanely-low yields is the Exact Wrong Thing (EWT) to do.

Unfortunately, my latest "student" was the cashier at the grocery store, who, it turns out, knows absolutely squat about what bonds are, although she admits that she has heard the word before.

Predictably, the conversation went nowhere until I commented about how prices are higher, and she says that a lot of customers are complaining about the higher prices.

Seizing the opportunity, I said, "That's because the foul Federal Reserve has been creating so many trillions of dollars for so many years! And now the Fed is going to create that much money every freaking year so that the Fed can use it to buy up the $2 trillion in bonds that the Treasury will have to float this year so that the Obama administration can deficit-spend it, which is so freaking much money pouring into the economy that it will make prices go up even more than they have!"

I thought I saw a glimmer of interest in her eyes at my brilliant synopsis of the situation in the way she kept nervously glancing over her shoulder at the manager so that he could, I assume, come over to share in this interesting conversation.

Encouraged, I continued, "And it is this inflation in prices that will make people say 'Buy bonds? Screw that!' and not buy bonds because they yield so little while inflation is so high, which means that if they buy the bonds that yield less than the rate of inflation in prices, they are actually losing money in the form of lower buying power!"

I looked directly at her to let her know that I was coming to my terrific summation, which is, "And that means that the bonds will have to yield more to attract buyers, which means that the prices of bonds will go down, handing an unrealized (at best!) capital loss on the owner of bonds! Now do you see why buying bonds is a bad idea?"

I looked at her expectantly, hoping that she would say, "Wow! Now I understand! Thanks for the information, Brilliant Handsome Stranger (BHS)! But, since you're so smart, how can I make a profit on this terrific analysis?" whereupon I would have told her to buy gold, silver and oil stocks.

But she didn't. She just looked at me with this stupid bored look on her face and, handing me the register tape, said in a monotone, "That'll be $138.62."

Perhaps she would have been more impressed by Mark Lundeen's Bear's Eye View (BEV) analysis, which contains the highly interesting facts that "Bond valuations in 2010 are obscenely inflated, with bond yields far below actual consumer price inflation. This is a highly unstable situation, very similar to the bond market of 1938 to 1981, a period when money invested in the bond market purchased only tickets to poverty. This is what happened as bond yields rose from 3% to 15%, while rising consumer prices gnawed away at the purchasing power of fixed income investments."

"Aha," I thought! "Even she could not fail to be impressed with the fact that the last time this happened, bond yields rose 500%!"

And that would be before her reading where he says, "Beginning in 1981, with the 30-year US Treasury Bond at record high yields of 15%, bonds began a 30-year bull market, just one year after gold began its 21-year bear market. But beginning in 2001, something very strange happened: gold and bond yield trends decoupled. For the past decade, rising gold prices sounded the siren of problems to come in the global financial markets, even as the bull market in bonds continued for an additional 10 years."

The best part is when he says, "As a matter of financial survival, bond yields should have been raised with the price of gold for the past 10 years, exactly as happened from 1969-80!" but that, ominously, they did not, and he goes on that while bond prices have not risen even as gold was signaling trouble of the inflationary kind aplenty, "I assure you that someday soon they will."

And the inflation that should be driving bond yields up and bond prices down, and which will soon be driving bond yields up and bond prices down, also means that gold, silver and oil will gloriously rise, rise, rise along with it, too, making it all so wonderfully easy that one will involuntarily gleefully shout, "Whee! This investing stuff is easy!"