The Real Rate Of Return On The 10-Year Treasury Note (T-Note) Is Still Low

Historical Real Rates Of Return On 10-Yr. Treasury Note (T-Note)

Period	10-Yr. T-Note (Avg. Yield)	CPI Headline (Avg.)	Real Rate (Yield-CPI)
1965-1969	5.3%	3.4%	1.9%
1970-1974	6.8%	6.1%	0.7%
1975-1979	8.2%	8.1%	0.1%
1980-1984	12.4%	7.6%	4.8%
1985-1989	8.8%	3.6%	5.2%
1990-1994	7.3%	3.7%	3.6%
1995-1999	6.1%	2.4%	3.7%
2000-2004	4.8%	2.6%	2.2%
2005-2009	4.1%	2.6%	1.5%
2010-2014	2.5%	2.0%	0.5%
2015-2017	2.1%	1.2%	0.9%
2/28/18	2.9%	2.2%	0.7%

Source: Bloomberg. Past performance is no guarantee of future results.

View from the Observation Deck

1. The real rate of return on a bond is calculated by subtracting the most recent inflation rate, such as the Consumer Price Index (CPI), from the bond's current yield. The higher the real rate the better.
2. As of the close of 3/16/18, the yield on the benchmark 10-year T-note was 2.85%, roughly the same as the 2.9% (rounded) yield at the close of 2/28/18 (see table), according to Bloomberg.
3. At the 2.9% level, the yield on the 10-year T-note is very low by historical standards. While it has climbed since it hit its all-time closing low of 1.36% (7/8/16), it stands well below its average yield of 6.34% since the start of 1965, according to Bloomberg.
4. The Federal Reserve has raised its federal funds target rate (upper bound) five times (25 basis points each) to 1.50% since December 16, 2015. The futures market puts the probability of another Fed rate hike at 100% for this week's meeting (3/20-3/21), according to Bloomberg. We are expecting the Fed to raise the rate to 1.75%.
5. While we do not know how many times the Fed is going to raise its benchmark lending rate during this tightening phase, we do know that it raised rates 17 times for a total of 425 basis points (from 1.00-5.25%) from June 2004 through June 2006 – its last tightening phase. The yield on the 10-year T-note stood at 5.25% on 6/28/06, matching the 5.25% federal funds target rate, according to Bloomberg.
6. Despite the meager real rate of return generated by the 10-year T-note of late, investors have not shied away from government bonds. Retail investors funneled an estimated net $7.76 billion into U.S. Intermediate Government mutual funds and exchange-traded funds for the 12-month period ended 1/31/18, according to Morningstar. They also funneled an estimated net $12.07 billion into U.S. Long Government funds over the same period. They did not, however, buy into the short-end of the yield curve. U.S. Short Government funds had estimated net outflows totaling $574 million.

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