THE WALL STREET JOURNAL.
WSJ.com

JUNE 3, 2009

TIPS Regain Their Popularity: Investors Worry U.S. Stimulus Will Push Up Prices

By ROB COPELAND and MIN ZENG

Investors are flocking to inflation-protected Treasurys as fears grow that the government's efforts to revive the economy may set off a rise in prices.

For the first time since the collapse of Lehman Brothers in September, the yield gap between 10-year Treasury inflation-protected securities, or TIPS, and a 10-year nominal note, surpassed two percentage points, implying that investors are expecting annualized inflation of more than 2% over the next decade.

That marks a turnaround from the start of the year, when investors were so anxious about deflation that the gap was negligible. Now, the massive amount of money being pumped into the system is sparking fears that the Federal Reserve will be unable to keep a rein on prices.

"The market is very worried about the endgame for all these government-stimulus programs," said Donald Ellenberger, who helps oversee $8 billion in assets as co-head of government and mortgage-backed bonds at Federated Investors Inc. in Pittsburgh. "Given the enormous size of the fiscal bailout, the market is getting worried there could be a policy error."

A 2.01% inflation rate, as indicated by TIPS, would be slightly above the 1% to 2% that is generally perceived as the Fed's inflation target range.

Inflation worries began to take hold in the past week, pushing the 10-year Treasury yield above 3.7% for the first time since November and sparking concern that the Fed may be thwarted in its ultimate aim of keeping mortgage rates low. Rising inflation erodes the value of returns on fixed-rate securities over time.

Indeed, Tuesday's TIPS strength was driven by the recent selloff in nominal Treasurys, said John Brynjolfsson, chief investment officer of the Armored Wolf hedge fund. "Deflation is no longer in the cards," Mr. Brynjolfsson said. "Budget deficits, protectionism and regulation invariably will drive inflation in the direction that policy makers want to go -- higher."

The 10-year note settled up 22/32, or $6.875 per $1,000 face value, at 95 25/32. Its yield fell to 3.638%, from 3.715% on Monday, as yields move inversely to prices. The 30-year bond was up 1 7/32 to yield 4.486%.

Investors Pile In for Cheap TALF Funds

Investors applied for $11.45 billion in cheap funding from the Federal Reserve on Tuesday to purchase securities backed by consumer loans.

This is the fourth round of funding from the Fed under its Term Asset-Backed Securities Loan Facility, or TALF, which is aimed at restoring the asset-backed securities market. This market was particularly hard-hit by the credit crisis and has only recently returned to health.

Ahead of the loan application deadline, issuers ranging from banks and auto makers to equipment companies sold nearly $16 billion in asset-backed deals eligible for such funding. Issuers included Citigroup, which sold two TALF-eligible offerings backed by credit-card loans. Auto makers BMW, Nissan Motor and Ford Motor also sold securities backed by auto loans.

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Printed in The Wall Street Journal, page C13