

What Are U.S. Treasury Securities?

U.S. Treasury securities—such as bills, notes and bonds—are debt obligations of the U.S. government. When you buy a U.S. Treasury security, you are lending money to the federal government for a specified period of time.

Because these debt obligations are backed by the “full faith and credit” of the government, and thus by its ability to raise tax revenues and print currency, U.S. Treasury securities – or “Treasuries” – are generally considered the safest of all investments. They are viewed in the market as having virtually no “credit risk,” meaning that it is highly probable your interest and principal will be paid fully and on time.

Because of this unique degree of safety, interest rates are generally lower for this class of securities than for other widely traded debt, riskier debt securities such as corporate bonds. A good rule of thumb to follow is that safer investments offer lower returns. Conversely, the higher the risk, the higher the return.

The amount of marketable U.S. Treasury securities is huge, with \$7.3 trillion in outstanding bills, notes and bonds as of December 31, 2009*. The Treasury market is one of the world's most liquid debt markets, meaning it is one where pricing, executing and settling a trade is very efficient and thus inexpensive due, in part, to very tight bid/ask spreads. The average daily trading volume in U.S. Treasuries was \$409.8 billion in 2009** and these securities trade virtually 24 hours a day with the U.S. primary dealers making live and continuous markets in these securities each business day via trading desks in cities across the globe like Tokyo, London, and New York.

In 2009, the U.S. Federal Reserve estimated that 10.2% of bills, notes and bonds were held by individuals, 11.7% by banks and mutual funds, 6.6% by public and private pension funds, 47.7% by foreign investors, 6.8% by state and local governments and 16.9% by other investors.

The focus of this section is on marketable U.S. Treasury securities, those that are of most interest to individual investors because they trade on the open market. There are other classes of Treasury debt—non-marketable securities—that are not transferable but can be purchased from and redeemed by the government. U.S. Savings Bonds fall into this category, and, even though they are non-marketable, are discussed here because they are designed for individual investors.

Certificate of Indebtedness Law & Legal Definition

According to 31 CFR 356.2 [Title 31 -- Money and Finance: Treasury; Subtitle B -- Regulations Relating to Money and Finance; Chapter II -- Fiscal Service, Department of the Treasury; Subchapter B -- Bureau of the Public Debt; Part 356 -- Sale and Issue of Marketable Book-Entry Treasury Bills, Notes and Bonds (Department of the Treasury Circular, Public Debt Series No. 1-93); Subpart A -- General Information], certificate of indebtedness means “a one-day non-interest-bearing security that may be held in TreasuryDirect and that automatically matures and is rolled over each day until its owner requests that it be redeemed

How Interest Rate Changes Affect the Price of Bonds

Whether the interest rate movements are caused by Federal Reserve actions, economic conditions or inflation fears, the impact on the bond investor is the same: Rising interest rates reduce existing bond values and falling interest rates increase existing bond values.

Seems simple enough.

But how will your bond investments be affected by changes in interest rates?

Since bonds differ by maturity, coupon rate, type of issuer and other factors, figuring out how your bond or bond portfolio will be affected by interest rate changes can be complex. Fortunately, you don't need a math degree to understand the basic concepts. Here are some simple guidelines for judging the price volatility of your bonds.

What Affects Bond Price Volatility

The price that a bond sells for in the market today is the sum of all future cash flows, discounted in value because they are not available today. A dollar tomorrow is worth less to you than a dollar today. The discount rate used is the rate of interest prevailing in the market for bonds of the same risk and maturity. When that interest rate changes, it affects the price of all bonds, but to varying degrees.

The longer the maturity of your bond investments, the greater the price volatility.

Why?

The reason is that the maturity value of the long-term bond, as well as many of the interest payments that are being paid, are future cash flows that are very distant points in the future. If interest rates rise, those very distant cash flows of the long-term bond are discounted in value significantly, and the price of the long-term bond falls in the market abruptly.

Coupon rates—the periodic interest payment that is paid by the issuer of the bond—also affect bond price volatility. A higher coupon means that more cash in the form of interest payments flows to the investor before maturity than is the case with a lower coupon bond. What this means is that when interest rates rise and future cash flows are discounted at a higher rate, the lower coupon bond has relatively more cash flow in the distant future, the maturity value of the bond represents a greater portion of the total cash flow, and the bond's value today will fall relatively more.

Combining these characteristics produces the riskiest bonds in terms of price volatility: The most price volatile bonds are those with longer maturities and lower coupons. A long-term zero-coupon bond defines the outer boundary for riskiness.

Investors who are risk averse should look for bonds and bond mutual funds that have shorter average maturities—less than five years—and should avoid zero-coupon bonds, particularly long-term zero-coupon bonds.

How Much Prices Will Change

[Table 1](#) indicates just how much bond prices can change when interest rates change. The table shows the percentage change in bond price for a given interest rate change for bonds of different maturities and two different coupon rates. The table is based on the assumption of semiannual interest payments and bonds selling at their maturity (face) value. Because of the mathematics of the relative change, the gains are always larger than the losses for the same interest rate change.

As an example of how to read the table, assume that you have a bond with a 30-year maturity and a 6% coupon rate. If you anticipate that interest rates will drop two percentage points, say from 6% to 4%, your bond will rise in value by 34.7%. A bond selling at a face value of \$1,000 before the interest rate drop would rise to \$1,347, for a gain of \$347. On the down side, however, if interest rates instead rose to 8%, your bond would decrease in value by 22.6%, to \$774, for a capital loss of \$226. Both of these interest rate changes are a bit on the high side but not impossible, and the gains and losses are large because the bond maturity is so long.

Wells Fargo

October 24 Wells Fargo fallout could tally \$4 billion in lost revenue, up to 30% customer drop After weeks of ugly headlines, the worst of the fallout may just be starting for Wells Fargo, according to a new study on the bank's troubles. The scandal in which Wells Fargo admitted to signing up millions of customers for

programs without their knowledge or consent initially cost it a \$185 million fine. However, that could be only the beginning as the reputational damage intensifies. The bank stands to lose \$100 billion in deposits, \$4 billion in revenue and a customer base that could dwindle by up to 30 percent, a study released Monday by cg42 showed. Steve Beck, founder of cg42 and a competitive strategy expert, said in a phone interview. "The breach of trust the scandal created has fundamentally changed the way that they think about their institution, the way they think about the bank." The effort to get customers into additional products is known as cross-selling and served as a cornerstone of the San Francisco-based bank's growth strategy. Wells Fargo officials did not immediately respond to a request for comment. Note: I am begging you, pleading with you to close all as in ALL accounts with Wells Fargo. NOW get out, GET out, GET OUT while the getting is good. This includes all brokerage accounts, credit cards. And while you're at it check your pension, retirement accounts, brokerage accounts, credit union and local bank to make sure Wells Fargo is not their correspondent. Of course your bank and fund well deny any association... Because here is a news flash, ALL, as in ALL bankers are lying.. One way to check who your small banks correspondent is, check and see if they use Wells Fargo for wire transfers. They cannot stand this loss in their client base. It will put them under. I repeat, there is a run on Wells Fargo as we speak. Sorry if the sold out financial press and the Controller of the Currency refuses to report this. I am told they are afraid of creating panic. Hear me well, you need to panic and get out, get out, get out NOW!