



### ***US Treasuries: Why We Should Be Terrified***

The CDS market for US Treasuries is relatively new because treasuries were considered “risk-free” prior to our current financial crisis. As you can see from the chart below, CDS prices are up more than 10X in the last 8 months. This price movement represents a clear message from the CDS market: over the last 8 months the risk of our government defaulting on its debt obligations has increased 10X. Foreign and domestic investors will demand higher yields, to be compensated for the risk of lending money to the US treasury for 20+ years. Would you accept a 2%-3% return to lend money to an entity for 20+ years that is leveraging itself up with no end in sight? The government can control the short end of the treasury yield curve by lowering fed fund rates and other measures, but not the long end of the curve, which is determined by investor demand and their willingness to lend money to the treasury.

This thesis has nothing to do with inflation, but rather simple credit risk, which not enough investors are paying attention to. The government continues to run the currency printing presses and in the very near term this could have severe consequences. In our opinion, this fragile economy simply can't handle the strain of significantly higher long term interest rates. In fact, we believe that this could be the straw that breaks the camel's back. In addition, at some point in the future, possibly deep into the future, this excessive money creation will lead to higher levels of inflation and a depressed US dollar. The government's current stimulus plan only exacerbates the problem because the frictional costs are so high. In other words, for every dollar the government spends, the consumer is likely to gain in the vicinity of thirty cents at most of benefit based on the government's track record of allocating capital and managing complex projects.

#### **How Can Investors Benefit?**

Buying an ultrashort 20+ year treasury product provides an avenue to take advantage of this thesis. An investor is betting that the long term treasury bond rates will increase as prices drop.

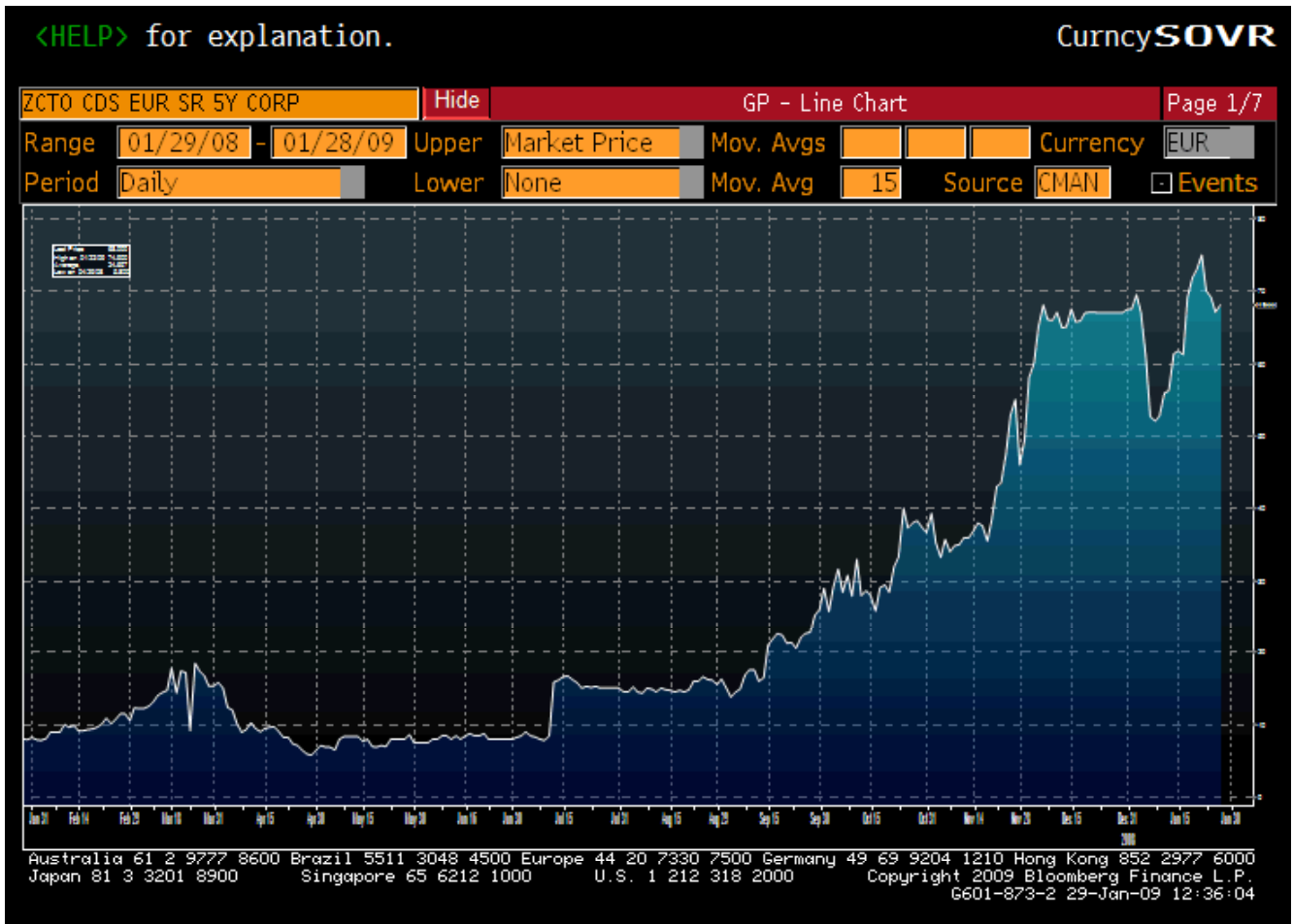
#### **How Can The Market Recover?**

The only way to solve this crisis is to implement low frictional cost program to put money back in the hands of the people who earned it so they can pay down their debt and begin to forge a healthy balance of spending and saving. This could come in the form of significant tax reform which would need to coincide with a significant reduction in the size of government, given the lower tax revenue base. This, of course, is highly unlikely to occur. The more likely and potentially most powerful program that could be implemented would be a government backed 4% mortgage program which would allow every American with a mortgage to refinance into a mortgage that saves them 25% per year. This would put \$400-\$500 per month in the hands of every mortgage payer, given that the average US mortgage is currently at 6%. More importantly, this enormous refinance boom would refinance most of the toxic mortgages off the bank's balance sheets and would therefore help our banks balance sheets and the consumer at the same time.

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## CDS Prices



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