Harry’s Take

February 22, 2022

What’s the Best Way To Play Safe-Haven Long-Term Treasuries?

I obviously get a lot of questions about how to choose the best Treasury bonds or ETFs, given my unique safe-haven recommendation for long-term Treasuries over gold in the once-in-a-lifetime deflationary crash ahead. In the end, gold is an inflationary play. Treasuries are the proven deflationary hedge.

Your options are the 10-year and 30-year for the longer dated Treasuries. The 30-years are far superior, even for playing a short-term deflationary shock, as the longer-term duration makes them more potent and volatile. But there are also two ETFs that you can play long Treasuries with: TLT, which averages 20-year duration (combo of 10- and 30-year) and XROZ, with a 25-year average, obviously with more 30-year weighting.

I greatly favor 30-year Treasury bonds over 10-year bonds if you buy them direct and the ZROZ over the TLT in the ETF realm, in both cases due to the leverage of longer yield lock-in.

Let me first repeat a chart I put out a few years ago comparing appreciation in the 30-year bond vs. in the 10-year bond, in a projected deflationary downturn scenario back then wherein the 30-year yield at the time was projected to fall from 1.75% to 0.40% and the 10-year yield to fall from 0.96% down to 0.0%. This chart shows that the 30-year greatly outperformed the other, with a projected 38.1% gain vs. 9.5% on the 10-year (and 22.0% on the TLT ETF discussed ahead). The zero-coupon 30-year bonds with no interest paid are even more leveraged, and that return would have been a whopping 49.6%. There's no contest for the 30-year here, with zero coupons the best.

Big Difference in Appreciation from Deflation Scenario on 30-Year vs. 10-Year Treasuries

Returns in Deflation Scenario Wherein 10-Year T-Bond Rates Fall from 0.96% to 0% and 30-Year From 1.75% to 0.4%*

	Gains
10-Year T-Bond	9.5%
30-year T-Bond	38.1%
Zero Coupon 30-Year**	49.6%
TLT ETF (Avg. 20-Year)	22.0%

*This is roughly proportional to the sudden fall in yields during the February to March Covid-19 stock crash, except this scenario would be a bit deeper.

** Zero Coupon means you buy the bond stripped of the interest payments at a discount for that and that creates more leverage. You can also buy "strips" to do this which are more common.

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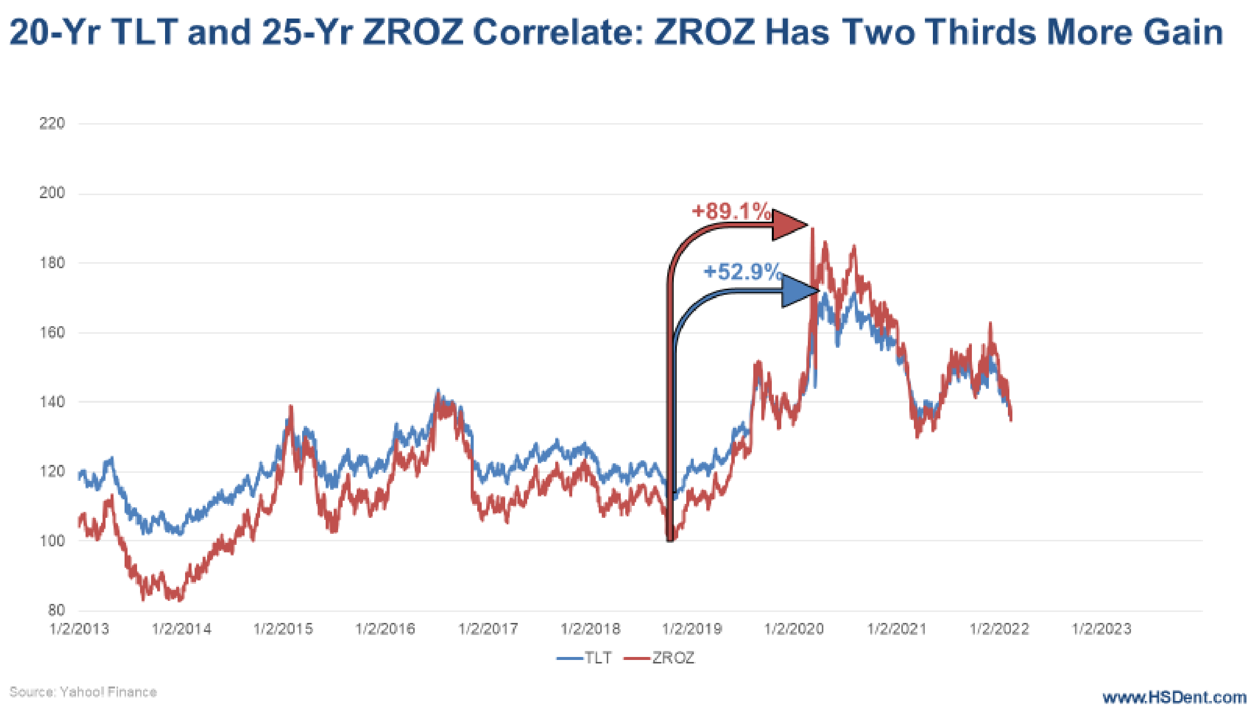
Now, in the chart below, let's look at the two ETFs mentioned above and compare the returns on ZROZ, at 25-year average maturity, vs. TLT, at 20-year average maturity, in the strongest short-term rally in years from December 2018 into March 2020, which peaked into the COVID crisis (proof T-bonds do well in a crisis even without deflation).



The rise from December 2018 into March 2020 was 89.1% on ZROZ vs. 52.9% on TLT. That's 68% better in a 1.3-year rally just for that 25-year vs. 20-year duration advantage. Note that, given that ratio of outperformance to TLT, ZROZ likely would have seen gains around 37% in the previous scenario, very close to the 30-year bond at 38.1%. The advantage of TLT is simply that it is traded at much higher volume and is a little more efficient for getting better trade fills. But since we are not looking to trade but just to buy once and then sell a year or two later, this is not a significant disadvantage.

Technically, the best way to play this deflationary shock is still to buy 30-year Treasuries directly and, even better, buy the zero-coupon versions if you can. But a very close second-best and easier way is simply to buy the ETF ZROZ. For a 1- to 2-year play like this, I'll take the ZROZ.

Harry

Got a question or comment? You can reach us at info@hsdent.com.