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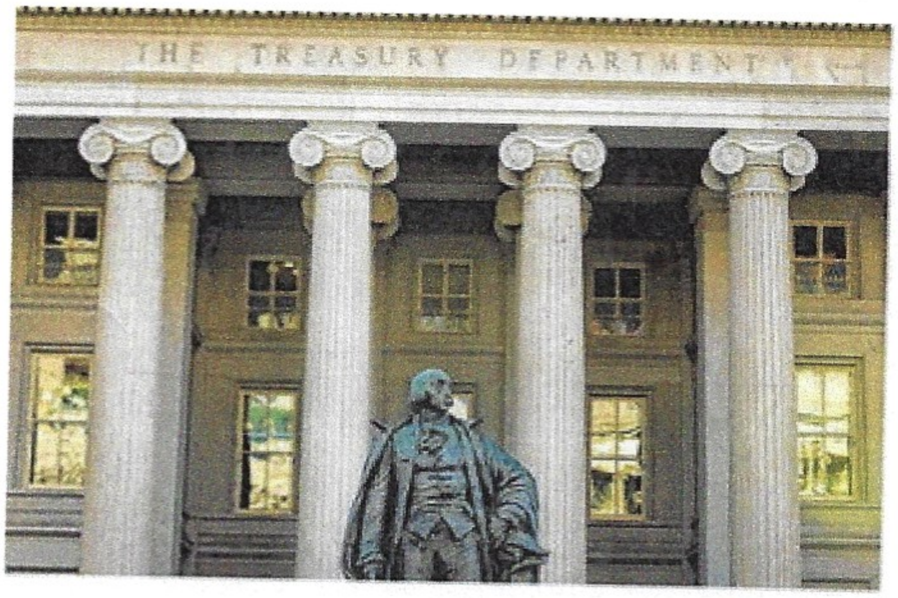

ISAMUEL CORUM/ BLOOMBERG NEWS Yields could keep climbing if the U.S. Treasury Department has to accelerate its borrowing to cover bigger deficits.

Why Bond Yields Are Up Amid Rate Cuts

BY BEN EISEN AND SAM GOLDFARB

If you are trying to figure out whether now is the time to buy bonds, watch the White House more than the Federal Reserve.

The benchmark 10-year Treasury yield has been rising toward 5%, Fed interest-rate cuts be damned. The central bank held its own rates steady Wednesday after trimming by a full percentage point since last fall.

Long-term U.S. government-bond yields have been taking their cue less from the Fed than from President Trump. He took office last week promising to cut taxes, enact tariffs and deport immigrants. Many investors believe these policies will grow the federal deficit and stoke inflation, fueling the latest push toward higher yields. *

The state of play

Right now, uncertainty is at an extreme. A measure of all the unknowable factors baked into Treasury yields beyond baseline rate expectations, called the term premium, has recently been at its highest level in years, according to some estimates.

The rise in yields has kept borrowing costs high for everything from mortgages to corporate debt. Higher rates tend to weigh on stocks, too. Meanwhile, the rise in yields has handed paper losses to many bond investors, because rising yields are the result of falling bond prices.

That might not matter if you are planning to buy and hold the bonds until they mature, collecting interest along the way and finally getting back your full principal. If you are buying Treasurys because their yield looks attractive now and you don't have a longerterm plan, there are some factors you should consider:

1 Buying Treasurys that mature in two years or more amounts to a bet that yields will stabilize or fall as Trump's agenda takes shape and the uncertainty dissipates.

2 You might want to avoid long-term Treasurys, such as those maturing in 10 years, if you are of the mind that rates will rise further because of higher inflation and ballooning deficits.

Plenty of people disagree on what happens next. BlackRock Chief Executive Larry Fink said recently that 10-year Treasury yields could rise to as much as 5.5%. Morgan Stanley researchers say yields will fall to 3.55% by the end of the year.

The bull case

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The 10-year Treasury note on Tuesday had a yield of 4.55%. This month it went as high as 4.8%. The Fed's short-term rates are currently lower, at a range between 4.25% and 4.5%.

It stands to reason that longterm Treasury rates shouldn't drift too far above short-term rates. The biggest influence on 10-year yields is typically what investors expect short-term rates to average over the next 10 years, and the Fed is still in a period of cutting rates, not raising them.

Once Trump's policies come into focus, their effect on the Treasury market may fade, shrinking the term premium. Already, some predict that Trump's bark is worse than his bite. Goldman Sachs, for example, recently predicted tariffs won't be as extensive and all-encompassing as initially expected.

The bear case

Trump already threatened 25% tariffs and economic sanctions on Colombia recently because the South American country didn't accept demands to repatriate migrants. He backed off after Colombia agreed to his terms, the White House said. Still, there is now momentum behind an effort to place tariffs on Canada and Mexico.

Given these developments, it is easy to imagine that some of the fear baked into that term premium becomes reality. Some hypotheticals:

1 The promised tariffs lift inflation, forcing the Fed to keep rates at current high levels or raise them.

2 The mass deportation of immigrants leads to labor shortages that drive up the cost of construction and restaurant meals.

3 Tax cuts lower the federal government's revenue, increasing deficits that prompt the U.S. government to borrow more. Investors, faced with a larger supply of Treasurys, demand higher yields to own them.

No one knows whether any of this will happen. Higher yields could also be self-limiting if the Trump administration responds by changing course. BlackRock's Fink, for example, said in his interview that yields above 5% could start a conversation about shrinking the deficit.

Those who are bearish on Treasurys at their current yields might choose to wait for a better moment to buy. Or they might buy short-term Treasurys such as bills that mature in a few months but offer almost as much yield. Inflation-protected Treasurys, whose face value rises with inflation, are another option.