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The U. S. Government Bond Yield Curve
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Investors are impatient with high quality low yielding money market and fixed-income options, but no real change is expected soon. Due to the Federal Reserve's near zero interest-rate policy, designed to stimulate the economy, the government bond yield curve will not be allowed to change with market forces and thereby become normalized in the foreseeable future.

The Federal Reserve's dual role is to create an economic environment that fosters full employment and secondarily to manage inflationary expectations. But during the past 36 months, the Fed has faced a third challenge –rebuilding international confidence of U.S. banks. To do this, large regional and national banks were forced to accept massive capital infusions from the Fed. This standby capital was in essence a backstop to hold back a post 2008 global economic collapse. So far, this policy has worked, but at a cost to bond investors who no longer expect positive real rates of return.

Currently, the Fed manages the government bond yield curve. It purchases government securities, thereby holding prices at higher levels, causing lower yields. Its inaction would allow the yield curve to rise. The result would be good and bad. First, rising rates would attract foreign capital – which in turn drives up the U.S. dollar. This would bring import costs down, namely oil and manufactured goods and inflationary expectations would diminish with the strong dollar. Bond prices would fall, meaning higher yields with a fixed coupon. Consumers would benefit from lower household costs and retirees would be comforted with higher fixed-income yields.

As long as the U.S. Government maintains a high debt load, the resultant rise in its borrowing costs will be staggering. Therefore, the challenge is to wait long enough for a strong economy that generates higher tax receipts that would in theory offset higher borrowing costs. Given the trajectory of the U.S. economic recovery, as measured by a slow +2.5% GDP growth rate and slow private sector job growth, it is too early to call when the Fed will allow policy rates to seek normal or market determined levels.