

**MONEY TALKS: Searching For A Risk-Free Rate Of Investment**

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NEW YORK (Dow Jones)--The safe-haven status afforded to U.S. Treasurys has disrupted their traditional role as the purest representation of the cost of a "risk-free" investment.

While the markets remain in crisis mode, investors looking for a new benchmark for default-free bond investments may do worse than turn to the new bank debt guaranteed by the government.

Investors use the "risk-free rate" to gauge the relative value of their other investments. Because governments have the power to print money, there is - at least in theory - no risk that they will default on debt denominated in their own currency.

There can be other threats, however, and U.S. Treasurys have been in such demand as a safe haven in the credit storm that they are no longer reflecting any risk. The yield on three-month U.S. Treasury bills has plunged since the credit crunch took hold in September and October, and is currently 0.01%. At times, investors were even willing to lose a bit of money in order to preserve as much of their capital as possible.

Given the chaos in other asset classes, that desperation among some investors is comprehensible. But for the broader swath of the investment community, the low yields make Treasurys a hard platform from which to judge the riskiness of their other investments.

The uncertainty is reflected in the cost of protecting against a default by the U.S. government, which has soared in recent weeks: Investors are willing to pay nearly \$60,000 per year for five years to protect \$10 billion of bonds, up from about \$14,000 in early September. There's no suggestion the U.S. is ever going to default, but clearly some investors are concerned about the risks that exist.

*The Treasurys rally has been "overdone," said Rod Olea, director of fixed income at City National Asset Management in Beverly Hills, Calif. By lowering interest rates, the Federal Reserve has essentially made cash a "worthless asset" to try to encourage people to start taking on risk, he said. With plenty of cash being pumped into the system, "you can't say there will be no inflation 10 years from now," he said.*

As the government extends its guarantees further into the marketplace, there are a growing number of candidates as the new "risk-free" rate. Some are looking at securities issued or backed by mortgage giants Fannie Mae (FNM) and Freddie Mac (FRE), which the U.S. government recently said it would start to buy in large numbers. Yet there's still plenty of uncertainty about the ultimate destiny of these companies.

That's why some investors are looking at the short-term debt issued by banks under the government's guarantee program as the latest measure by which to judge other types of bonds. While the outlook for the banks themselves is far from clear, the three-year government guarantee on new debt provides a fairly safe base.

"Spreads (risk premiums) to Treasury stand around 200 basis points, and while some of that could be considered compensation for liquidity risk, one could also contemplate that interest rate as the relevant benchmark rate ... for other issuers accessing debt markets those rates represent the floor to borrowing costs," Banc of America Securities said in a report this week.

This doesn't mean that the bank debt is going to replace Treasuries,, merely that the yields on this debt provides a more stable reference point. So far, about \$32 billion in securities have been sold under the bank-debt program, which is tiny compared with the \$4.9 trillion Treasuries market. Liquidity should improve as more banks subscribe to the program, and as investors become more comfortable, the spread over Treasuries will probably start to narrow.

Nor will there be a yield curve of this debt to measure risk well into the future, as there is with Treasuries. The government will only insure debt issued before June 30, 2009, and those guarantees will last until June 30, 2012, although there's always the possibility the program might be extended.

Over time, Treasuries could resume the default-free mantle - depending on the risks. Otherwise, investors may have to start dealing with a world in which there is no such thing as a risk-free investment.

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