One Treasury Bill, Two Owners

By Viplav Nigam, Founder, LongShort.io



SAM

I brought a little something.

ALEX

Sam, that pot has handles for four people.

Over soup, Sam mentions a Treasury bill he bought a few months ago. Alex puts down her spoon. “Back up a second. Where did you actually buy it?”

Where do you buy one?

SAM

I used my brokerage account. That's the account I use to buy and sell investments. I picked a Treasury bill due in 26 weeks and asked my broker to put in an order at Treasury's next auction.

ALEX

What exactly did you order?

SAM

A bill that would pay me $1,000 when it came due. That's its face value. The auction set the price. In my case, $980 came out of my account, and the bill showed up there.

ALEX

Could I buy a new one straight from Treasury?

MAYA

Yes. TreasuryDirect.gov is Treasury's own website. You can choose a bill there and enter the face value in steps of $100. At the auction, you accept the price Treasury determines.

Under 18? A parent or eligible guardian can set up and manage a linked minor account at TreasuryDirect.

TreasuryDirect / How to buy at auction

Why am I paying you?



SAM

My broker says this bill could sell for $990 today.

ALEX

So I could buy an existing bill through a broker. If I bought yours, why would you get my money?

SAM

Think back to when I bought it. Who got my $980?

ALEX

Treasury did.

Maya turns over a placemat

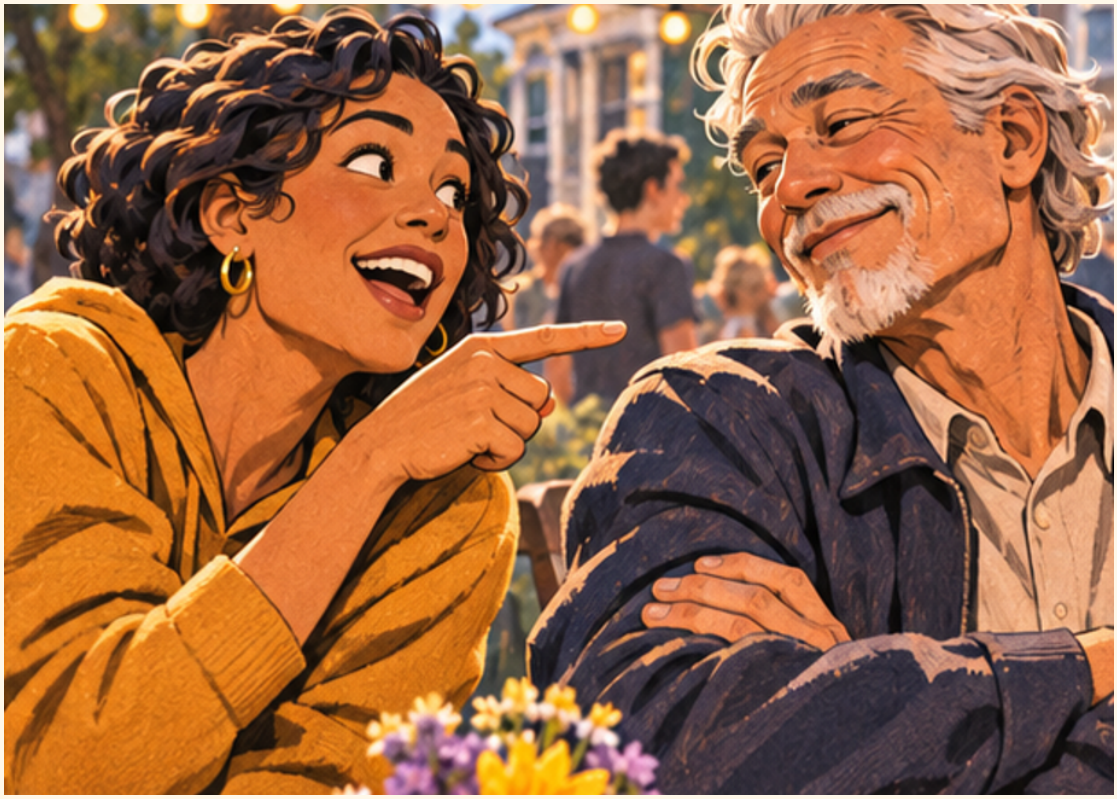


$980 — **Sam pays Treasury**
Treasury issues the bill. Sam now owns it.

$990 — **Alex pays Sam**
Sam sells the bill to Alex. Treasury receives no new money.

$1,000 — **Treasury pays Alex**
The bill comes due. Treasury pays its owner and the debt is settled.

Who paid Sam his ten dollars?



ALEX

Wait. I did! He paid $980. I paid him $990.

MAYA

And if you keep the bill until it comes due?

ALEX

Treasury pays me $1,000. I get my ten then.

Sam takes a photo of the placemat before anyone can put a bowl on it.

What if Sam waited?

Maya turns the placemat over. “Let’s rewind. Suppose Sam kept the bill a little longer. Why might someone pay more for it then?”

Alex thinks it over. “Treasury still pays $1,000. But now I’d get it sooner.” Suppose interest rates stay steady and the bill later trades at $995. Alex buys it then.

Sam receives the $995 sale price. He earns $15 on his $980 purchase. Alex earns the remaining $5 when Treasury pays her $1,000. Sam held the bill longer and Alex had less time to wait.

One last question from Alex

“What could change the price while Sam waits?”

About the example

Sam and Alex stand in for the seller and buyer in a brokered trade. Prices are illustrative and exclude trading costs and taxes. Treasury bills run from four to 52 weeks and can be sold before maturity. A bill bought at a discount and held to maturity pays the difference when Treasury repays its face value.

Read the original source: TreasuryDirect | Treasury Bills