A Perspective on 'Negative Yields'

August 2019

As investors become increasingly concerned about a slowing global economy and the U.S. trade war with China, they have been scooping up U.S. government bonds at a frenetic pace. Because bond yields move inversely with prices, the yield on the U.S.10-Year has fallen to a three-year low. While the Federal Reserve has only cut interest rates by 25 basis points, the yield on the U.S. 10-Year has fallen more than 100bps over the past four months. [1]

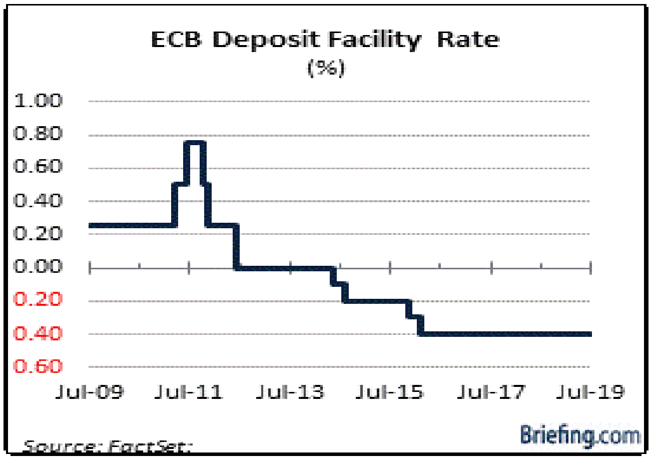
Source: YCharts, US Treasury

Rates are still far higher in the U.S. than in other parts of the developed world, however. Even after falling more than 100bps, the U.S.10-Year yields 1% more than the British 10-Year. [2] Furthermore, the same-duration bonds of France, Germany, and Japan are currently offering negative yields. In fact, there is more than $15 trillion in negative yielding government debt around the world. [3]

Negative yields and negative interest rates can be confusing but it is important to draw a distinction between the two. Bonds with a negative *yield* would result in a loss if the investor held the security to maturity. The negative *interest rates* at the European Central Bank & Bank of Japan refer to the overnight deposit rate. By charging banks to park money with the government, central banks hope this will incentivize the banks to lend more money inside their country's economy. Negative interest rates can be a little counterintuitive. Typically, lenders (in this case the banks) receive interest to compensate them for the risk of default. When interest

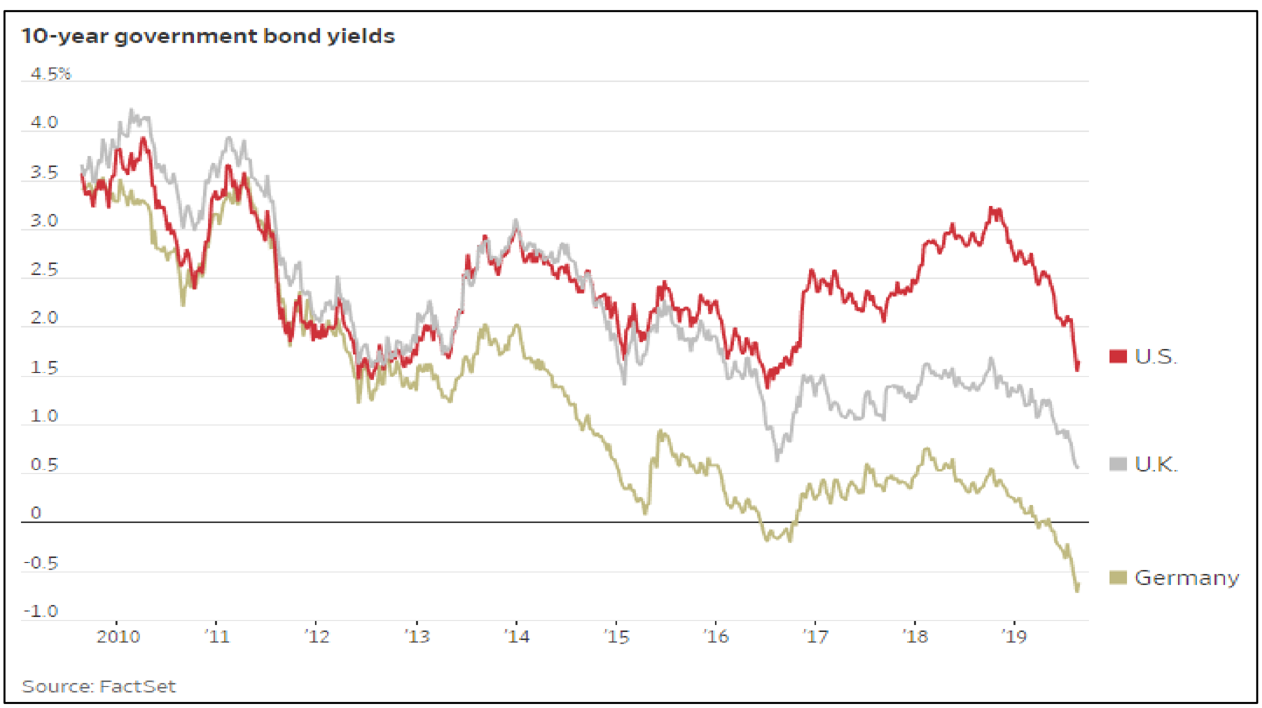
[1] Ycharts.com
[2] WSJ
[3] CNBC

rates are negative, the banks are effectively charged a fee to the government to store their money rather lend it out.



Source: Briefing.com, FactSet

With overnight rates in Europe already in the red, one of the few policy tools that remains is that of open market operations where the central bank purchases government bonds in order to stimulate growth. When this happens, bond prices rise, and yields fall. This has led to speculation on sovereign debt across Europe exacerabating the flattening yield curves in distressed countries like Italy and pushing the entire curve negative in "risk free" Germany.[4]



Source: WSJ, FactSet

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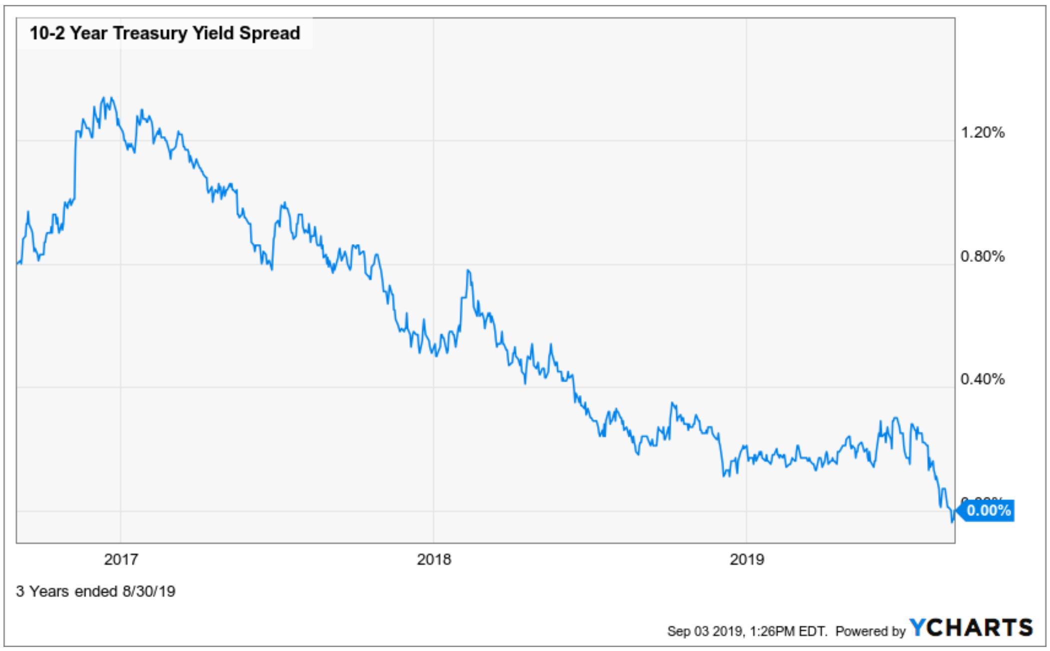
[4] Briefing.com

With $15 trillion in negative yielding government debt worldwide, investors wary of risk but in search of yield have few choices other than U.S.Treasuries, pushing domestic yields down. This has caused the U.S.yield curve to recently invert when the yield on the U.S. 10-Year fell below the 2-Year intraday.[5] Yield curve inversion occurs when longer dated treasuries have a lower yield-to-maturity than shorter dated securities. Typically, investors receive more yield for longer term investments. Inversion signals that investors are worried about the longer-term health of the economy. While the yield curve is currently not inverted, the spread between the yield on the 10-Year and 2-Year remains extremely narrow.



Source: YCharts, US Treasury

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Joseph Letts

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[5] Ycharts.com

DISCLOSURE:

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Investors bear the risk that the Fund may not be able to implement its investment strategies or attract sufficient assets. Purchased put options may decline in value or expire worthless and may have imperfect correlation to the value of the Fund's portfolio securities. Written call and put options may limit the Fund's participation in equity market gains and may amplify losses in market declines. The Fund's losses are potentially large in a written put or call transaction. If unhedged, written calls expose the Fund to potentially unlimited losses. The Fund will incur a loss as a result of a short position if the price of the short position instrument increases in value between the date of the short position sale and the date on which an offsetting position is purchased. Short positions may be considered speculative transactions and involve special risks, including greater reliance on the ability to accurately anticipate the future value of a security or instrument. The Fund's losses are potentially large in a short position transaction.

Investors are not able to invest directly in the indices referenced in this illustration and unmanaged index returns do not reflect any fees, expenses or sales charges.

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