Market insights

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What goes up ...

Key highlights:

- Lower yields may sound appealing to borrowers who face lower interest payments.
- But for some people, like pensioners, a decrease in yield can equate to a decrease in income.
- In the end, no one really knows what negative yields means for U.S. investors as they've never occurred in this country.

... Must go down?

Now appearing around the world is a surging tide of negative interest rates, which has recently reached a level of $15 trillion (see *Exhibit 1*). To put that in perspective, such an amount represents roughly 15% of the total global bond market. What do negative yields mean? For starters, it suggests that investors are so leery of other investment options that they are willing to place their money in assets that will provide less money than the principal invested. Essentially, instead of depositors receiving money for their deposits (meaning earning interest), they are paying banks to hold their money. This scenario stands the traditional banking relationship for investors on its head.

Exhibit 1: Rising tide of negative debt (As of 8/7/19)

Source: Deutsche Bank.

Potential impact on U.S. economy

Today, interest rates in the U.S. have not fallen below zero, but with the plunge in U.S. Treasury yields this month, including all-time lows for 30-year U.S. Treasury rates, many market watchers are starting to consider the possibility of negative rates appearing in the U.S. Helping to drive down rates is strong foreign demand for U.S. securities as offshore investors continue to use the U.S. as a safe haven as well as a source of positive income. On a net basis, foreign purchases of U.S. long-term securities soared from –$4,633 million in April to $63,757 million in June 2019 (the most recently available period).[1]

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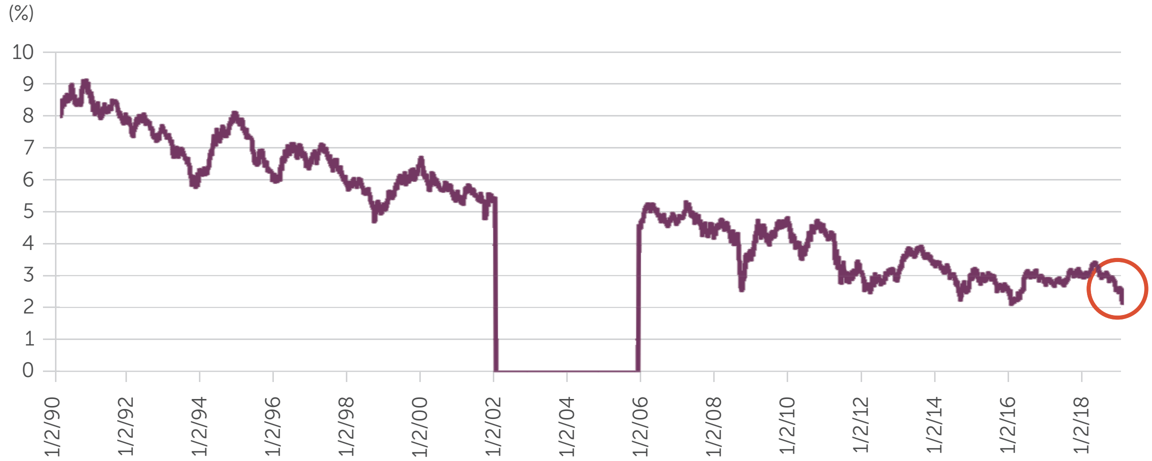
[1] U.S. Department of the Treasury, June 2019.

Exhibit 2: U.S. 30-year Treasury yield hits an all-time low (1/1/90 to 8/13/19)



Source: U.S. Department of the Treasury, 8/13/19. Note that the 30-year U.S. Treasury constant maturity series was discontinued on 2/18/02 and reintroduced on 2/9/06.

What does this mean to investors?

Upon first glance, low interest rates are very appealing to many borrowers including companies and mortgage holders, since the cost of servicing their debt decreases as rates fall off. However, low and negative interest rates are typically challenging for retirees who are trying to generate enough income from their assets to meet their liabilities. Now these same people will probably need to consider buying riskier assets in order to achieve their goals which could expose them to unwanted (and unfamiliar) risks. What's the bottom line? No one really knows what the potential impact of negative interest rates is since the U.S. has never experienced a similar yield regime before. The Federal Reserve, via its efforts to keep the economic expansion going, may continue to lower rates, but once rates get close to zero (or negative), then investors may increase their savings rate to offset lost investment income. This may lead to less spending, which typically decreases economic activity and consumer confidence, which, in the end, can negatively impact equities.

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