Market Report 12 || 2020

NEGATIVE GOVERNMENT BOND YIELDS HIT INVESTORS HARD

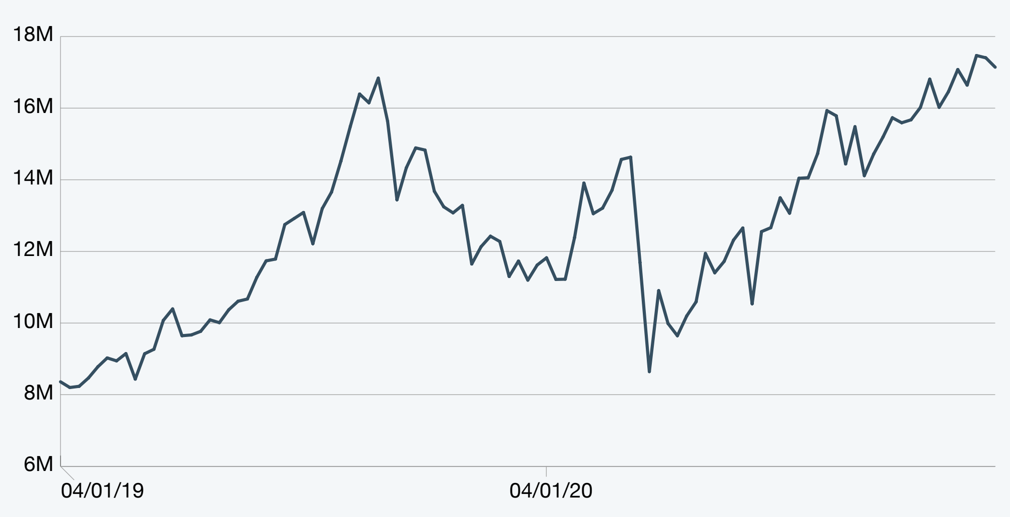
ThomasLloyd

Negative government bond yields hit investors hard

Where can investors make money these days? Not in government bonds, where the total stock of negative-yielding government bonds globally has reached an incredible **USD17.4 trillion.** That is USD17.4 trillion of bonds being held by pension funds and other institutions, which will pay back less than their nominal value, and will generate no interest income for the foreseeable future.

A combination of cuts in official policy interest rates (there have been 205 rate cuts around the world in 2020), Central Bank purchases of government and corporate bonds (Quantitative Easing) and regulatory measures on solvency and liquidity in the financial sector has increased flows of funds into sovereign bond markets.

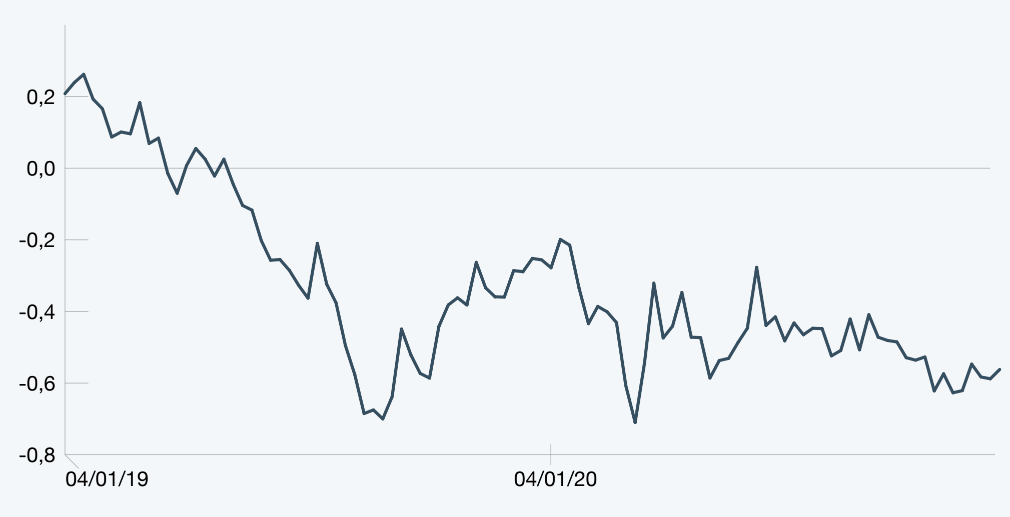
Total stock of negative-yielding government bonds (USD trillions)



Investors forced to take on more risk

This deliberate and globally concerted policy of 'financial repression' has forced investors to assume more risk in their portfolios, either by moving into assets with longer duration, lower credit quality, different currencies, or a weaker position in the capital structure. Equity dividends, meantime, have been reduced; whether voluntarily due to financial uncertainty and the need to preserve corporate cash, or by regulatory enforcement such as we have seen in the European banking sector.

Germany 10-year government bond yield (percent)



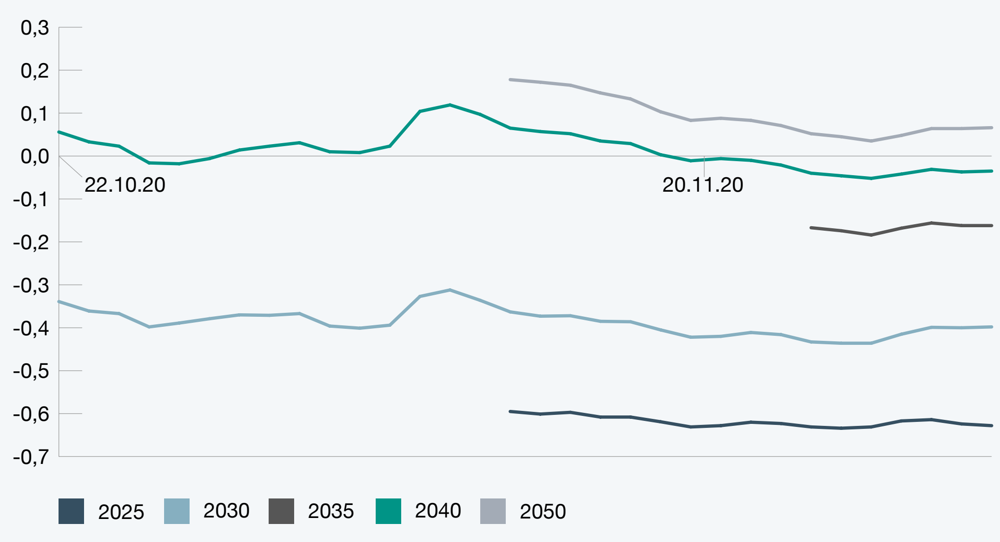
Having briefly dipped into negative territory between June and October 2016, 10-year German government bonds moved sustainably below zero in H1 2019 and have stayed there ever since, reaching an all-time low of -0.85% at the depths of the COVID-driven panic in financial markets in March 2020. Despite a subsequent modest recovery, yields have been -0.40% or lower every day thus far in H2 2020.

Selected Emerging Market 5-year USD-denominated government bond yields (percent)

Emerging market government bond yields at all-time lows

Tumbling yields have not only been a feature of the most highly developed and best-rated government bond markets. The search for yield to help meet income objectives or to fund future pension liabilities has been a global phenomenon, and has driven a drop in yields in some quite unlikely places. Looking at a selection of Emerging Market economies which issue government debt denominated in US Dollars, we see that from Latin America, through Russia and down into South East Asia, 5-year yields are now lower than at the depths of the COVID panic. In every case, yields are below 2.0%; with the Philippines recently hitting an all-time low of just 0.77bp.

EU Bond Yields issued in Q4 2020 under SURE Programme (percent)



The degree of financial repression in Europe is well-illustrated by the terms upon which the European Union has been able to issue so-called ‘social bonds’ under its Support to mitigate Unemployment Risk in an Emergency (SURE) programme. Thus far in Q4 2020, the EU has issued five SURE bonds with maturities from 5 to 30 years, with zero coupons, for a total issuance of €39.5billion. At current prices, only one of these bonds has a yield to maturity above zero. An investor has to extend duration all the way out to 30 years to obtain a positive yield of just 6bp. Holding all the other bonds to maturity is guaranteed to produce a capital loss.

Low interest rates are here to stay

The fixed-income investment landscape of the past 12 – 24 months isn’t going away anytime soon. The sheer volume of sovereign debt issuance over this period makes an early ‘normalisation’ of monetary policy difficult to imagine. Official interest rates cannot be raised for fear of prompting a stock market slide, whilst increasing government bond yields will be prevented by further Central Bank asset purchases.

Investors looking for income should seek out private debt backed with government-guaranteed income streams

In the post-COVID, recessionary environment of late 2020, the scares and alarms of the public markets and the absolute certainty of capital losses on negative-yielding government or corporate debt held to maturity should substantially increase the relative attractions of private debt. Shielded from public markets’ volatility, backed by infrastructure projects with long-dated income streams guaranteed by the same governments able to issue traditional debt at these historic levels, real assets, like those found in the ThomasLloyd suite of Funds, offer the most favourable alternative source of income especially for pensions funds. Investors looking to replace their income which has been lost in sovereign bond markets due to extraordinary monetary policies, can instead find the government-sponsored and supported income streams in the market for private infrastructure debt.

Investing in sustainable real assets now is a win:win of current income generation, while working towards a cleaner, safer planet for our children and grandchildren.