Mitch on the Markets

Global Bond Yields are Bottoming Out

By Mitch Zacks
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Government bond yields across the globe are in serious decline – and have been for some time now. Investors are paying closer attention to yields these days, however, because in many developed countries like Japan, Germany, France, and the Netherlands 10-year bond yields have actually turned *negative.*[1]

The chart below shows the methodical, steady decline of government bond yields over the last 20+ years:

Source: Federal Reserve Bank of St. Louis[2]

So, what does this mean for investors?

First let me state the obvious: if you want to own 10-year government bonds in a country where the yield is negative, *you have to **pay money** to loan that government money.* If that's a head-scratching proposition, it should be. Even though government bonds of highly developed countries are considered "risk-free," you'd still nominally lose money over a 10-year period (not to mention factoring in the purchasing power effects of inflation).

Buying 10-year government bonds in countries where the yield is still positive, such as in the U.S., U.K., or Australia, does not do an investor too much better. Here are the 10-year yields as of close on July 5th:[3]

- United States: 2.037%
- United Kingdom: 0.739%
- Australia: 1.293%

Not exactly what we'd call 'inspiring' yields, and certainly not what investors would hope to receive in return for locking money up for 10 years.

The cause of the decline in global bond yields has a few sources, but it's also difficult to pinpoint exactly where the pressure is coming from. In Germany, for instance, there is a short supply of government debt securities as the country is notoriously frugal and sports a low debt-to-GDP ratio. There are only $1.7 trillion of German government debt securities, compared to $16 trillion for the U.S. When demand for German 'bunds' drives up prices, yields fall.

But the biggest factor in declining bond yields, I would argue, is low inflation expectations tied to the "muddle-through" GDP growth we've come to expect from the global economy in this expansion. Central banks across the world have set a low bar for interest rates and the consensus is that easy monetary policy will remain the status quo for 2019. I do not expect a breakout for rates any time soon as a result.

For consumers, lower rates can be a plus – the average 30-year mortgage rate dipped from 5% in November to around 3.8% as of last week, according to data from Freddie Mac.[4]

But for investors, paltry yields on risk-free debt can present challenges. Many retirees bank on Treasuries and government debt as safe sources for yield, which in turn can provide steady retirement income and cash flow in an investment portfolio. But securing a yield lower than 2% over 10 years is not many retirees' idea of a good investment. And it probably shouldn't be.

Where Can Investors Turn to Find Yield in a Low-Interest Rate Environment?

Government bonds are not the only fixed income options in the marketplace. Here at Zacks Investment Management, we look to high grade corporate bonds and municipal bonds as other areas where we can diversify away from Treasuries, in an effort to create yield and cash flow in a strategy.

But investors should also remember that stocks can be a good source of cash flow, too. For one, many high-quality dividend stocks often pay yields exceeding 2%, and an investor could explore a dividend stock strategy that generates yield in excess of the 10- or even the 30-year U.S. Treasury. Of course, investing in stocks means enduring the volatility associated with equity investing, but for investors with a long time horizon or a higher risk tolerance – or both – dividend stocks can potentially be a useful alternative for yield.

Bottom Line for Investors

In an investment marketplace starved of risk-free yield, it can be challenging for income-seeking investors to find reliable sources of cash flow. But it's not impossible. Investors can explore higher yield alternatives in the form of high-grade corporate bonds, municipals, or even dividend-paying stocks. We diversify across all of those categories at Zacks Investment Management, and would be happy to discuss them further with you.

About Mitch Zacks

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] The Wall Street Journal, July 8, 2019. https://www.wsj.com/market-data/bonds/governmentbonds

[2] Federal Reserve Bank of St. Louis, June 14, 2019. https://fred.stlouisfed.org/series/IRLTLT01EZM156N

[3] The Wall Street Journal, July 8, 2019. https://www.wsj.com/market-data/bonds/governmentbonds

[4] The Wall Street Journal, June 23, 2019. https://www.wsj.com/articles/world-economy-comes-to-grips-with-bond-yield-plunge-11561311410

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