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Negative-yielding debt reaches $17 trillion

Alfred Lam, CFA, Senior Vice-President and Chief Investment Officer
Marchello Holditch, CFA, Vice-President and Portfolio Manager
CI Multi-Asset Management

Negative bond yields occur when issuers of debt are *paid* to borrow. This unusual situation has taken financial markets by storm as negative-yielding debt recently reached an unprecedented $17,000,000,000,000 globally.

What drives negative yields?

- The Bank of Japan and the European Central Bank have set interest rates below zero for quite some time. At the time of writing, the Bank of Japan's interest rate is -0.1% and the European Central Bank's deposit rate is -0.5%. As global economies slow due to trade tensions, central banks globally have vowed to cut interest rates. It is widely expected that interest rates will fall to zero or close to zero in all major economies, including the U.S. In Japan and Europe, rates may fall further from already negative levels. Bond yields are effectively the average of future interest rates.

- Bond prices have been bid up through quantitative easing, an unconventional policy in which central banks purchase bonds in the market to increase money supply and encourage lending. The price of a bond and its yield are inversely related. This means higher the price, the lower the interest rate offered.

What are the implications?

- Due to low and negative interest rates, bonds with positive yields are in high demand. This helps to explain the recent rally in North American bond markets.

10-year yield
%

U.S.	1.55	Japan	-0.24
Canada	1.29	Belgium	-0.29
New Zealand	1.18	France	-0.34
Australia	1.07	Finland	-0.36
Italy	0.88	Austria	-0.37
U.K.	0.50	Netherlands	-0.5
		Denmark	-0.61
		Germany	-0.64
		Switzerland	-0.92

Source: Bloomberg L.P., as at September 6, 2019.

- Investors who purchase negative yielding bonds and hold them to maturity are guaranteed a loss. However, if yields fall further from the existing negative levels, these investors could potentially earn a capital gain before maturity. For this reason, we are actively managing our bond positions as their prices fluctuate. For example, we have some exposure to Japanese bonds as we expect yields to continue to fall.

- Negative yields encourage more borrowing as it becomes easier to break even. The majority of bonds with negative yields are government bonds. Since governments hold the power to tax their citizens and to print money, the risk of default is very low. Bonds issued by businesses and individuals generally have higher yields. The difference in these yields compared to government bond yields is known as the "risk premium." The risk premium compensates investors for the higher risk of default and varies based on creditworthiness. As government borrowing rates fall, borrowing rates for businesses and individuals also fall. Most businesses are borrowing at a range between -0.5% to 3% on a five-year term. The good news is that an investment needs very little return to cover the interest expense.

In summary, while negative yielding bonds are unusual, they are not surprising as central banks continue to implement unprecedented polices. We believe the implications could lead to investment opportunities.

Source: Bloomberg L.P.

Combined top 15 equity holdings as of August 31, 2019 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Microsoft	6. Canadian Natural Resources	11. Alphabet
2. Enbridge	7. Gilead Sciences	12. Magna International
3. Franco-Nevada	8. IA Financial	13. Brookfield Asset Management
4. AltaGas	9. Toronto-Dominion Bank	14. Canadian National Railway
5. Atco	10. Royal Bank of Canada	15. E-L Financial