VIZIONARY WEALTH MANAGEMENT
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The Weekly Note
A Weekly Market Commentary

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"Bond yields continue to collapse as global growth slows"

Last week, the 10-year Treasury yield fell back under 2%, the lowest level since late 2016. A spike in economic growth and several Fed rate hikes gave U.S. treasuries only a brief glimpse of breaking the long-term downward trend in yields in late 2017/early 2018. Now that the Fed is once again turning dovish and global growth appears to be slowing, yields seem destined to remain low for the immediate future.

Globally, there is now a record $13 Trillion of government debt that yields less than zero[1] including the 10-year German bund that last week hit a new low of ***minus*** 0.35%. In another sign of how crazy the yield story is in Europe, consider the fact that yields on 10-year Greek government bonds trade near 2% (similar to the 10-year U.S. Treasury). This is the same Greece that still has nearly 18% unemployment and was on the brink of default and removal from the Eurozone in late 2011 causing yields on these government bonds to reach highs of nearly 44%.

Greece 10-year Government Bond Yields

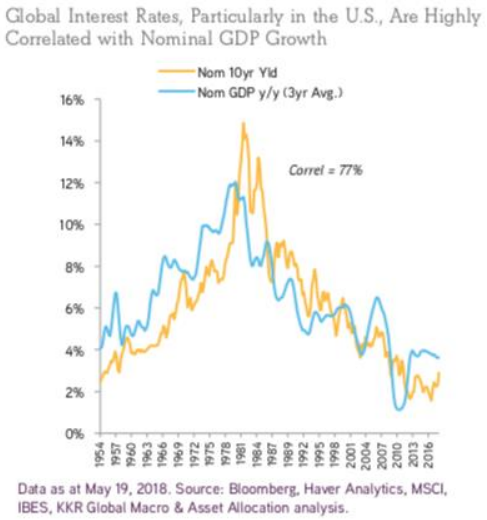
Even Austria, a country not exactly of the highest economic pedigree, is considering a follow-on offering of its 100-year bonds issued in 2017. Those 100-year bonds (yes one hundred years) due 2117 trade at a premium to par and yield around 1.12%[2]. The fact that the 2017 bonds have been bid up in price shows that there is plenty of investor demand (driven by Central Banks) willing to tie up capital for that long at such paltry rates, or at least speculate that yields will fall further causing bond prices to temporarily rise.

So when you read or hear narratives that there is no way interest rates could head lower, you need only reference Europe or even Japan who has seen its own government bond yields hover under 2% for the past two decades. It also may seem like we discuss the story of bond yields ad nauseam, but these return equations violate most sensible financial models and are a major factor for the persistent valuation premium given to stocks in spite of less-than-stellar economic growth.

Along with the perceived credit risk, bond yields are in many ways a reflection of growth expectations net of currency valuations for respective economies. The fact that bond yields in Europe have remained low over the past decade while growth languishes is not a coincidence.

It is tough to distinguish how much U.S. bond yields are a reflection of a potential domestic growth slowdown or the relative value vs. other sovereign debt, but it is likely a product of both. It is tough to expect yields in the U.S. to trend substantially higher if there is $13 Trillion of investable bond market capital willing to pay negative yields for safety capital.

Still, if you look at the long-term trend in nominal U.S. gross domestic product (G.D.P.) vs. 10-year U.S. Treasury yields there appears to be a very high correlation. We saw a brief jump in yields coupled with a temporary spike in growth after corporate tax reform was passed in late 2017. The recent trend lower in yield could be an indication of an upcoming slowdown in growth.



It may seem crazy to encourage a higher debt burden for the U.S., but taking a page out of Austria's playbook and financing fiscal spending for the next 100-years at these yield levels is not a bad idea. The magnitude of each percentage point higher on fiscal deficits is huge, so why not take advantage of these extraordinary times to the benefit of the nation's burdensome interest costs.

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Sources:

1. https://www.bloomberg.com/news/articles/2019-06-21/the-world-now-has-13-trillion-of-debt-with-below-zero-yields
2. https://www.bloomberg.com/opinion/articles/2019-06-25/a-100-year-austrian-bond-at-1-2-what-fresh-madness-is-this