



# Looking Beyond Negative Yields

Globally diversified bonds still play a key role in portfolios.

December 2019

## KEY INSIGHTS

- We believe that bonds will continue to provide benefits in terms of both portfolio diversification and return in the years ahead.
- However, with absolute bond yields at low or even negative levels in some markets, these benefits may be muted relative to historical patterns.
- These dynamics heighten the need to take an active, global approach to a fixed income allocation that can provide opportunities to gain additional yield.

Bonds will continue to provide benefits in terms of both portfolio diversification and return in the years ahead, in our opinion. However, with absolute bond yields at low or even negative levels in some markets, we acknowledge that these benefits may be muted relative to historical patterns. These dynamics heighten the need to take an active, global approach to a fixed income allocation. Investors can diversify their bond allocations across regions and segments that provide opportunities to benefit from the total return potential of international or emerging markets or from the additional yield from currency hedges. From a broader asset allocation perspective, we believe bonds still provide an attractive source of diversification against equity market downturns.

### Accommodative Monetary Policies Likely to Continue

Years of negative benchmark lending rates and aggressive quantitative easing

policies from the Bank of Japan and the European Central Bank have driven yields on high-quality Japanese and eurozone government debt—and some corporate bonds—well into negative territory. We see little sign that these accommodative monetary policies will change in the foreseeable future, making it increasingly difficult for fixed income investors to generate income. However, we do not anticipate that the U.S. Federal Reserve would implement negative rates.

Of course, a negative return on a bond with a negative yield is only guaranteed if an investor holds the bond to maturity. While it is possible that yields could become even more negative, providing opportunities for price appreciation by selling a bond before it matures, we believe it is more prudent to seek to generate total return in more efficient ways.



**Steven Boothe, CFA**

*Head of Investment-Grade Credit  
and Portfolio Manager*



**Lowell Yura, CFA**

*Head of Multi-Asset Solutions,  
North America*

“...a negative return on a bond with a negative yield is only guaranteed if an investor holds the bond to maturity.”

“...we expect a fixed income allocation to provide a useful hedge against a future downturn in stocks.

### **Opportunities to Diversify Outside Government Bonds**

One potential source of return from bonds is carry,<sup>1</sup> which measures incremental yield. From a broad asset allocation perspective, carry becomes particularly important when equity markets are not following clear upward or downward trends. To find bonds with more potential for carry, investors can look to securitized debt such as mortgage- and asset-backed securities, which typically offer higher coupons than Treasuries. Corporate bonds provide attractive coupons and carry along with higher credit risk, making fundamental credit analysis vital. Bank loans, which have noninvestment-grade credit ratings but receive repayment priority over bonds in the event of issuer default, are a market that has expanded meaningfully in recent years and can generate attractive carry.

Corporate bonds from issuers in developed international and emerging markets can also offer beneficial carry. Issuance of emerging markets bonds has grown meaningfully in recent years, providing more potential opportunities in a market that has also become higher quality. In addition, hedging the currency exposure in non-U.S. dollar-denominated bonds back to dollars can generate additional yield. This hedged yield results from the difference in short-term yields between non-U.S. currencies—short-term rates are very low in euros, for example—and U.S. dollar short-term rates.

### **Bond Allocations Continue to Provide Diversification**

While the income available from bonds has fallen with global yields, we believe

that a core bond allocation will continue to be an attractive source of diversification against a bear market in equities. The rolling 12-month returns for the Bloomberg Barclays U.S. Aggregate Bond Index were negatively correlated with the returns of the S&P 500 Index during the eurozone debt crisis in 2012 and 2013, during the global financial crisis in 2007 and 2008, and in the early 2000s after the bursting of the dot-com stock bubble.<sup>2</sup>

Bonds continue to benefit during periods of risk aversion, so we expect a fixed income allocation to provide a useful hedge against a future downturn in stocks. With equity valuations at elevated levels relative to historical averages, our expectations for stock returns are muted, potentially making this diversification even more valuable.

### **Active Management Essential on Many Levels**

Active portfolio management is an essential component of an effective fixed income allocation. This can take the form of fundamental credit analysis to inform security selection, which is particularly important in segments that provide higher carry. Another form of active portfolio management involves tactical allocation to bonds in non-core segments such as emerging markets. At the broadest level, multi-asset portfolio managers can help optimize an investor's allocations across asset classes based on an economic outlook and tolerance for risk.

<sup>1</sup> Carry is a bond's coupon minus the cost of cash financing.

<sup>2</sup> Sources: Bloomberg Index Services Limited and S&P/Haver Analytics (see Additional Disclosures).



---

## WHAT WE'RE WATCHING NEXT

Healthy consumer spending has underpinned the U.S. economy in 2019 as manufacturing has shown continuing signs of weakness, weighing on corporate capital expenditures. With the Fed seeming unlikely to cut rates further in the near term, we are closely monitoring consumer sentiment surveys to evaluate whether consumers will maintain their spending pace and support the economy.

---

### Additional Disclosures

Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

Copyright © 2019, S&P Global Market Intelligence (and its affiliates, as applicable). Reproduction of any information, data or material, including ratings ("Content") in any form is prohibited except with the prior written permission of the relevant party. Such party, its affiliates and suppliers ("Content Providers") do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. In no event shall Content Providers be liable for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold such investment or security, does not address the suitability of an investment or security and should not be relied on as investment advice. Credit ratings are statements of opinions and are not statements of fact.

## INVEST WITH CONFIDENCE<sup>SM</sup>

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

# T.RowePrice<sup>®</sup>

### Important Information

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

**Australia**—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

**Canada**—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

**EEA ex-UK**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**Hong Kong**—Issued by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

**New Zealand**—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

**Singapore**—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**USA**—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2019 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the bighorn sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc.