

Wickham Investment Counsel Inc.

Quarterly Review

October, 2019

Negative Bond Yields Anybody?

Global bond yields today are lower than at any time in the history of the financial markets. Rates are negative through the entire yield curves of Germany, Switzerland and the Netherlands; most of the Euro zone area and Japan. About **\$17 trillion USD of global debt** outstanding now bears **negative** rates. Most of the world's negative yielding debt is government bonds, but some is corporate debt as well.

Monetary policy makers from all corners of the globe are cutting interest rates and the current easing cycle is still ongoing. In North America, the US Federal funds target is 1.75 % - 2.00 % and the ten year Treasury bond yields 1.69 %, while in Canada the policy rate is 1.75 % and the Government of Canada bond yield is 1.36 %. It is likely that the US Fed will cut rates for the third time later this year, and this will put pressure on Canada to do the same. Is it just a matter of time before the **sub-zero rates** spread from Europe and Japan to North America?

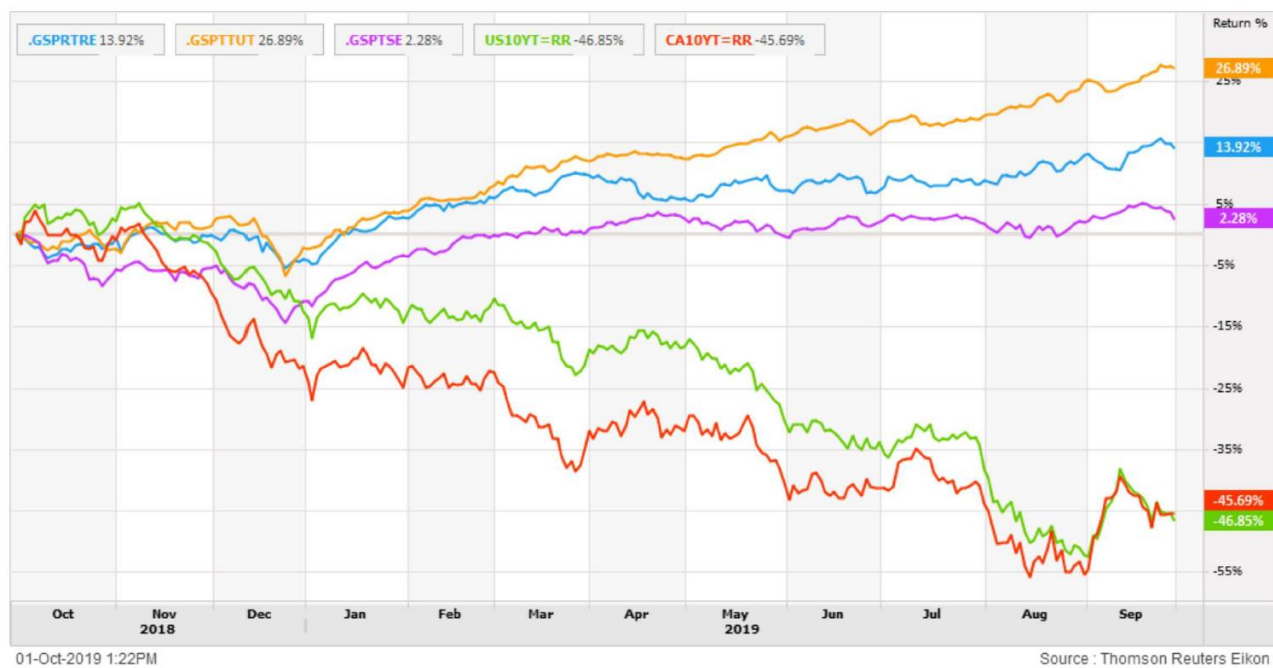
Low yields could be attributable to a number of factors, including low global inflation, aging populations, excessive balance sheet leverage and globalization. The bigger threat is a prolonged period of lower economic growth and low inflation, also known as the Japanese disease, or a fear of global economic stagflation.

The most powerful central banker in the world is the Chairman of the US Federal Reserve. His mandate is to promote full employment and price stability. Unemployment in the US is at the lowest point in fifty years. The target for inflation is 2 % per annum. This stable inflation target has not been achieved over the past decade. But in general, employment is full, economic and corporate profit growth is trending higher and prices are stable. It seems likely that interest rates will remain positive in North America. We think the policy rate in both Canada and the US will move to 1.50 % in the year ahead.

But this makes for a discouraging investment environment for the risk adverse, income focused investor. If a ten year government bond yields a nominal 1.50 %, after inflation the return is zero and after taxes, it is negative. On top of that, if interest rates rise, the bond will decline in price. Low return and risky. Income strategies could include short maturing corporate bonds and mortgage funds, alternative investments with yield, preferred shares and defensive, better quality dividend paying stocks and real estate investment trusts.

Valuation and liquidity are also important as many of these types of investments like utilities, consumer staples, pipe lines and real estate investment trusts have received large inflows this year. This is not a time to be greedy. Markets were terrified of higher interest rates in the fourth quarter of 2018. But equity markets this year have closely followed the inverse path of inflation adjusted bonds yields, having a profound effect on stock market valuations, and shooting market indexes to record highs.

S&P/TSX REIT vs S&P/TSX Canadian Utilities vs S&P/TSX Composite Index vs US 10 Yr Bond Yield vs Canada 10 Yr Bond Yield



	Dec 31, 2012	Dec 31, 2013	Dec 31, 2014	Dec 31, 2015	Dec 31, 2016	Dec 31, 2017	Dec 31, 2018	Sep 30, 2019	% Change Dec-Sep
Stock Market Indices									
S&P/TSX Comp.	12,434	13,622	14,632	13,010	15,288	16,209	14,323	16,659	16.31%
Dow Jones Ind.	13,104	16,577	17,823	17,425	19,763	24,719	23,328	26,917	15.38%
S&P 500	1,426	1,848	2,059	2,044	2,239	2,674	2,507	2,977	18.75%
Nasdaq Comp.	3,020	4,177	4,736	5,007	5,383	6,903	6,635	7,999	20.56%
Commodities									
Gold - US\$	1,676	1,202	1,184	1,060	1,252	1,309	1,281	1,473	14.98%
Crude Oil WTI - US\$	91.82	98.42	53.27	37.04	53.72	60.42	45.41	54.07	19.07%
Natural Gas - US\$	3.44	4.25	2.91	2.35	3.74	2.95	2.94	2.33	-20.75%
Currencies									
€ in Cdn \$	1.31	1.47	1.41	1.50	1.42	1.50	1.56	1.44	-7.53%
£ in Cdn \$	1.62	1.76	1.82	2.04	1.66	1.69	1.74	1.63	-6.53%
US\$ in Cdn \$	0.99	1.06	1.16	1.38	1.34	1.26	1.37	1.32	-3.39%
Interest Rates									
Cdn Prime rate	3.00	3.00	3.00	2.70	2.70	3.20	3.95	3.95	0.00%
US Prime rate	3.25	3.25	3.25	3.50	3.50	4.50	5.50	5.00	-9.09%
Cdn 10 Yr bond	1.80	2.78	1.79	1.41	1.72	2.04	1.95	1.36	-30.26%
US 10 Yr bond	1.63	3.03	2.17	2.27	2.44	2.40	2.69	1.69	-37.17%

Source: The Globe & Mail