



Dear present and future clients:

When I was younger—much younger—I awoke every Christmas morning to stocking stuffers and presents under the tree. When I was in third or fourth grade, the stocking stuffers included a passbook savings account, with a \$50 gift from Santa. Besides offering a great lesson on savings, my parents provided a simple explanation of bank savings accounts and monthly interest. If I remember correctly, my FDIC-insured savings earned 5%.

How times have changed! Rates are much lower today. But it's a much more difficult situation for savers in many developed nations. ...And that's the topic of this month's letter, "negative interest rates".

The bond market turns upside down

Imagine that you no longer earn any money by lending cash to the government, i.e., buying government bonds. Instead, you'll pay the government to hold your cash.

Currently, all German government bonds offer yields below zero, while financial service providers UBS and Credit Suisse are planning to charge a small fee for clients that hold large cash balances (Bloomberg News).

We have not seen negative rates in the U.S., but in much of Europe and Japan, below-zero rates on government bonds are common, with over \$15 trillion (yes, trillion, that's not a misprint) in government debt sporting yields less than zero percent, according to Bloomberg News.

Table 1: Below Zero

10-Year Govt Bond	Yield
Swiss	-1.02%
Germany	-0.70%
Denmark	-0.68%
France	-0.40%
Sweden	-0.35%
Japan	-0.28%
Ireland	-0.09%
Spain	+0.11%
Portugal	+0.13%
U.K.	+0.48%
Italy	+1.00%
U.S.	+1.50%
Greece	+1.63%

Source: MktWatch, Bloomberg 8/30/19

How can you buy a bond with a rate that's below zero?

Well, let's say Germany issues a 10-year bond with a par value of 1,000 euros (German currency is denominated in euros). You won't pay Germany an annual coupon. Instead, you'll buy that bond at a price that's greater than 1,000 euros. At maturity, you'll receive 1,000 euros.

It's a great deal for Germany but it doesn't seem to make much sense for an investor. But that's today's new global reality.

What's going on?

Today, several factors are contributing to below-zero yields.

1. Inflation in Europe is very low.
2. Growth has been substandard in Europe for much of the decade. Global trade tensions are adding to the uncertainty, and Europe may be headed toward another recession.
3. The European Central Bank has been much more accommodative than the Federal Reserve and appears set to ease again this month.
4. There's too much cash sloshing around the globe that can't find a home in viable industrial projects. So, it finds a home in creditworthy government bonds.

The next question that usually surfaces: “Why should I care? I’m in the U.S.”

What happens around the globe can affect investors at home.

Below-zero yields in major countries can encourage foreign investors to seek out positive returns in other nations, including in U.S. Treasuries. Since yields and bond prices move in opposite directions, an influx of foreign cash pushes up U.S. bond prices and knocks down our yields here at home.

It’s one reason why the yield on the 30-year Treasury fell to a record low of 1.94% on August 28 (U.S. Treasury Dept.), and the benchmark 10-year Treasury sported a yield of less than 1.50% on the same day.

Clearly, it’s a far cry from the risk-free savings account I received on Christmas morning many years ago.

Bottom line

As I’ve recently emphasized, you must control what you can control. You can’t control the stock market, you can’t control headlines, and timing the market isn’t a realistic tool. But, you can control the portfolio.

Your plan should consider your time horizon, risk tolerance, and financial goals. There is always risk when investing, but we tailor our recommendations with your financial goals in mind.

If you feel unsure or have questions, let’s have a conversation. That’s what we’re here for.



As always, we're honored and humbled that you have given us the opportunity to serve as your financial advisors. Let us know if there is someone you care about that might need our help. Likewise, if there is someone you know that might want to receive these monthly emails, let us know and we will add them to the list.

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