HOW LOW CAN YOU GO

EDGE is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management and corporate finance. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments, and macroeconomic trends.

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"Everything is relative in this world, where change alone endures"

Leon Trotsky

Investors in high-quality, fixed income securities have been battling the low interest rate environment ever since the start of the financial crisis in 2008. Just as recently as a few years ago, market experts expected rates in the U.S. and abroad to trend back to long-term averages. So far that prediction has not come to fruition. In fact, most of the developed world seems to be in a race to the bottom of interest rate lows. Technically, the "bottom" may not be the bottom as rates have now broken the zero-bound in many developed countries.

Roughly one-third of all two-year sovereign debt is currently trading at a negative interest rate! The graph on the next page illustrates how two-year rates in the U.S. are yielding 0.85%, while rates in Japan, Germany, and Switzerland are yielding -0.22%, -0.56%, and -1.22%, respectively. As an example of how this works, Germany issued a two-year Bund on February 2nd 2016 at a price of 101.062 EUR with no coupon. Essentially, an investor has agreed to loan the German government 101.062 EUR, and in two years will receive 100 EUR with no interest! While we hopefully do not have to worry about negative rates in the U.S., the effect of negative rates across the globe has implications domestically.

Global investors fleeing negative rates in their home countries may seek safety in U.S. Treasury debt putting downward pressure on interest rates in the U.S. (aka The Carry Trade). We may be seeing this effect now. The Federal Reserve continues to suggest that everything is fine. Inflation is moderate, unemployment is back to its longer-run average, and the Fed even raised the Federal Funds rate with hints of additional increases to come. But the 10-year Treasury yield has dropped from 2.30% to 1.84%, and actually hit a low point of 1.54% since the December hike. So it seems the search for yield continues. Investors are finding sources of income in corporate bonds (both investment and non-investment grade), dividend paying stocks, and other investment options to lift income.

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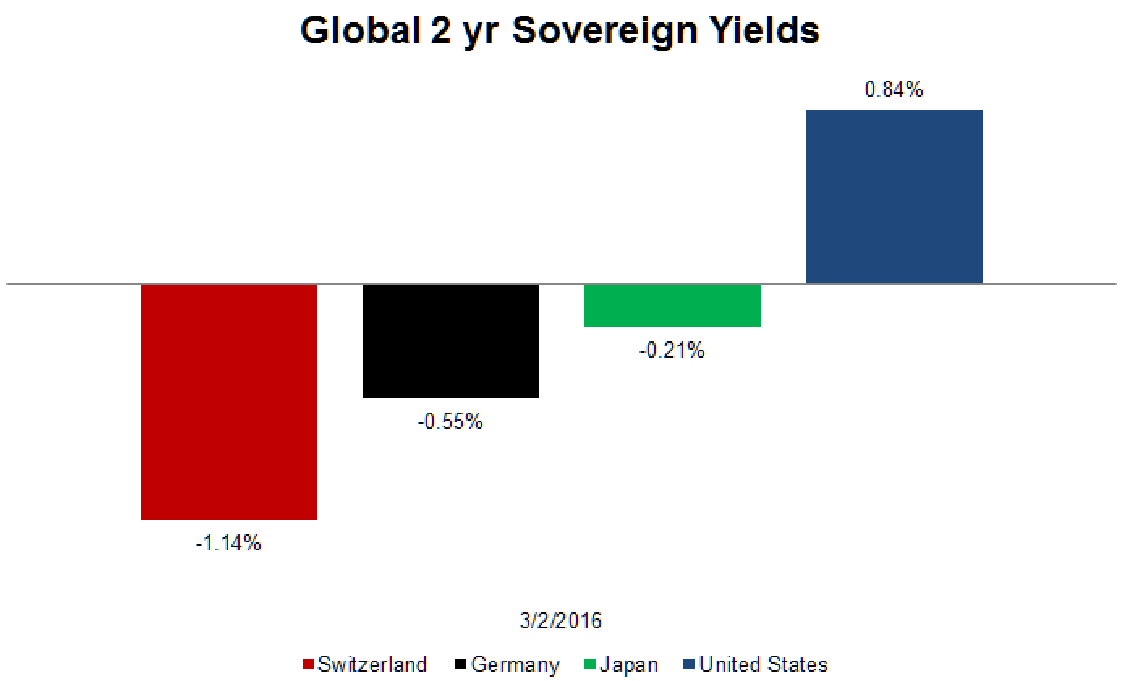
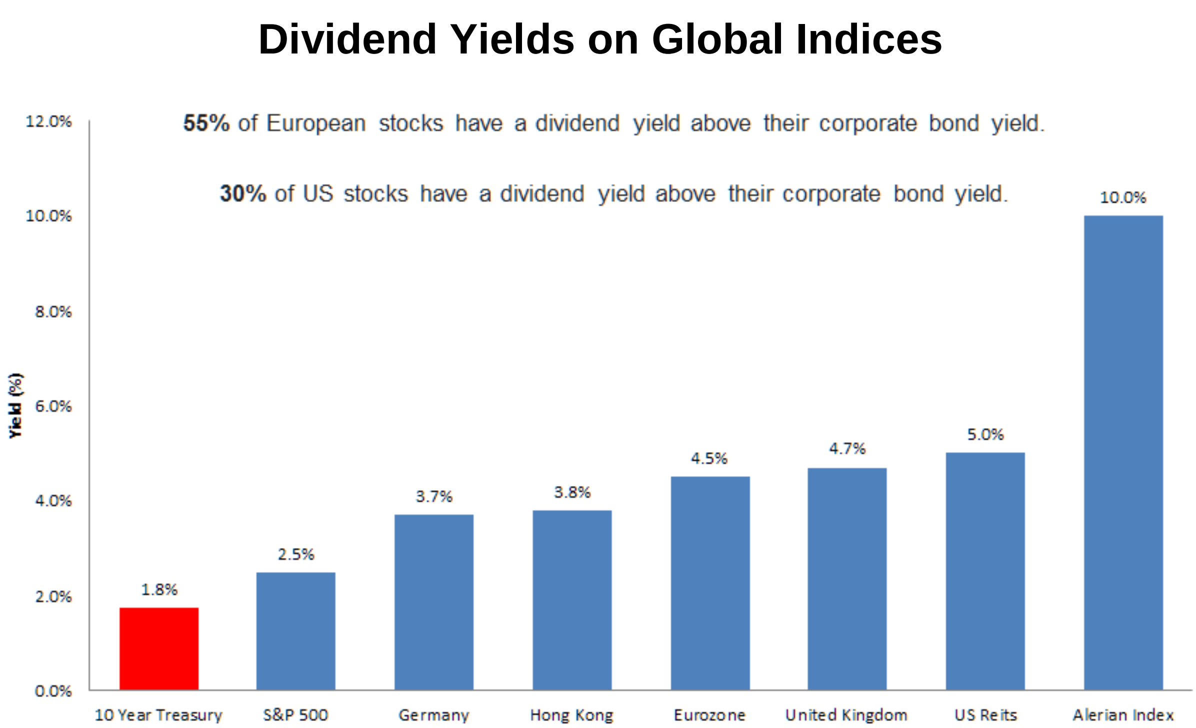


Source: Bloomberg



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