Bond Case Briefs

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How To Beat The Risk Of Negative Yields.

As the $14.5 trillion in global negative yielding bonds grows, what kind of maneuvering should you be doing?

First off, we older investors will never forget the Y2K scare and the disaster that never happened. Right now many investors are as worried about negative yields happening in the U.S. as we were worried about our computers in 1999 being unable to digest the changeover to 2000.

I quote the August 5 Barron's, which in turn quoted BofA Merrill Lynch Research: "Net buying in global bond funds is on pace to reach a "staggering record" of $455 billion in 2019, which compares with the $1.7 trillion of inflows over the past ten years."

For 2019, U.S. bond fund inflows have been huge. Investors have sold stocks for the safety of bond funds. You can look up the Lipper Fund Flows or Yardeni Research's excellent flow of funds charts to see the magnitude of this shift.

The point is, if we approach zero percent interest rates or heaven forbid, go to negative rates, my guesstimate is the money flows into bond funds of all types will become a tsunami.

Study the Vanguard Total International Bond Index Fund (VTIBX) with $131.6 billion under management. Its website states the fund has a 0.13% expense ratio and as of August 1, a 0.45% 30-day SEC yield. The yield is beyond paltry, I agree. But the near-term proposition looks even worse. As more investors flock to the fund, more bonds will be purchased at lower yields and even negative yields. Looking at the fund's largest holding, Bundesrepublic, Deutschland 0.25% maturing Feb. 15, 2029 which presently yields -0.538% this trend is not your friend.

We Baby Boomers have lived through unthinkable market occurrences. So the Central Bankers bringing negative yields to our bond market won't be any surprise.

What should you do? If ever there was a time to leave bond funds and switch to individual bonds, it's now. Granted, with a flat yield curve with 2-year U.S. Treasurys yielding 1.74% and the 10-year at 1.84% you aren't getting paid to extend your maturities. But swim against the current and do it anyway. Load up on 5-9 year bonds. If this wave hits our shores your one-year CDs or two-year corporate bond yields will quickly evaporate.

Your risk in switching to individual bonds is minimal. The Federal Reserve isn't going to do any harm. In fact, expect lower bond yields for a protracted time as global investors push and shove to invest in our bond market where U.S. yields out strip theirs by a mile. And, the slowdown in the global economy will keep a lid on rates.

If you are looking for taxable income, invest in corporate names like Motorola Solutions, Biogen, Constellation Brands, Delta Airlines and Citigroup. Find the right maturities for your portfolio and spread them out.

Municipal bonds are another story. The flood of money in June, July and August has swamped the market. Add to that the massive maturities, coupon interest and calls; maybe waiting to invest in September if you are a first-time muni investor is a good idea. For others, when your munis are called or mature redeploy your funds—don't wait for higher rates this year—it's not going to happen.

My favorite municipal bond sectors remain airport revenue bonds issued by the top ten largest U.S. airports. Also the largest, most active harbor bonds are a favorite even though tonnage is down due to the trade war with China. Stay away from small cities and counties, small hospitals and utilities. Cyberattacks are occurring fast and furious on the smallest, most vulnerable and least likely to employ the latest in cyber security.

There is a lot happening. Generating portfolio income is getting harder. Bond funds will not be your easy way out. As money flows into both domestic and foreign bonds funds, you can potentially get stuck earning a few measly basis points or no basis points. The paradigm has shifted.

Forbes

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