Charts that Matter Corporate bonds

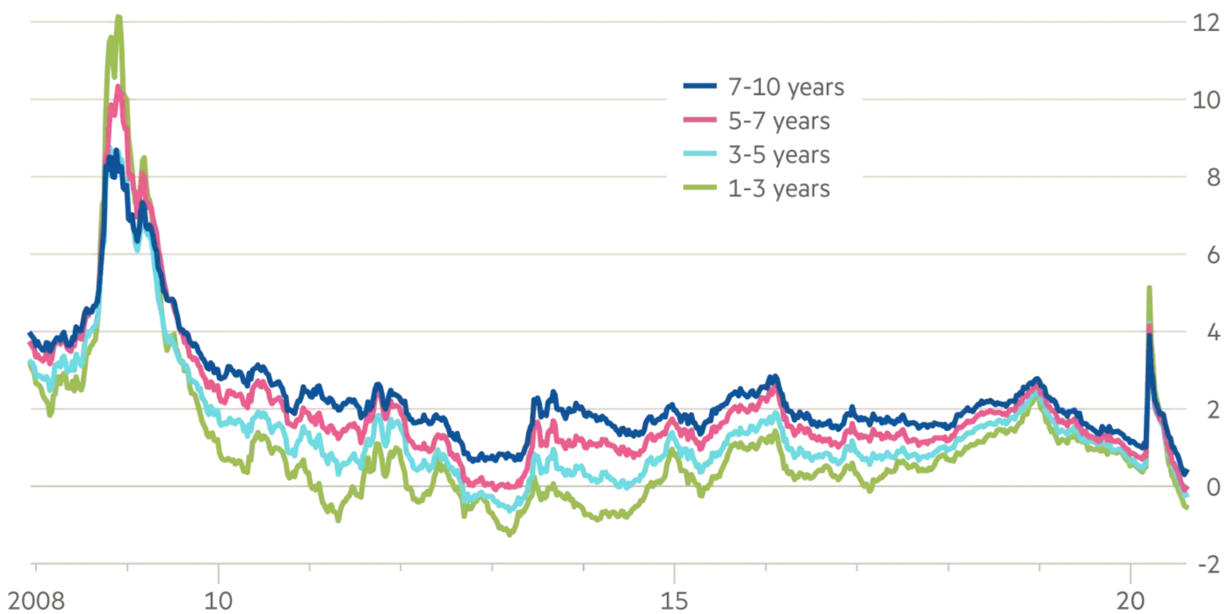
Pandemic sends real yields on corporate debt into negative territory

Low interest rates and monetary stimulus drag down yields of high quality bonds

Joe Rennison in London AUGUST 31 2020

US corporate bonds 'real yields' turn negative

Average yield minus breakeven inflation rate (%)



Source: Ice Data Services

The vast scale of central bank support for the corporate bond market has fired up prices to the point where some investors are willing to accept a loss for buying them, once inflation is taken into account.

After blasting higher in the financial-market ructions of March, the real yields on some high-quality US corporate bonds, which strip out inflation expectations from basic nominal yields, have slipped below zero.

For investment-grade corporate bonds with a maturity of between one and three years, this marks the first dip into negative territory since March 2017, when a newly inaugurated President Donald Trump's promise of tax cuts helped push inflation expectations above bond yields. Longer-dated bonds with a maturity of between five and seven years posted negative real yields this month for the first time since 2013.

Real yields on government debt have been negative for most of the year, reflecting large cuts to nominal interest rates and the expectation that rates and growth will stay low.

Corporate bond prices have shot higher too, particularly since the Fed pledged to buy company debt for the first time. That has pulled down yields, while expectations for rising inflation have built up for the months and years ahead.

One effect of sinking real yields is that, just as some fund managers have shifted from government to corporate debt, others will now seek out higher returns in riskier assets, such as lower-quality corporate bonds.

Bill Zox, a portfolio manager at Diamond Hill Capital Management, says investors are forced "to bear more risk if you want to be confident that you are going to generate a yield above inflation." In that context, he said, the US high-yield market looks like one of the "safest" places to seek solid returns.

Low interest rates compared with inflation could help reduce the burden of debt taken on by corporate America to outlast the pandemic.

"Policymakers globally are hell-bent on keeping interest rates below the level of inflation to allow debt levels to stabilise and ultimately come down," said Mr Zox.