REGISTERED INVESTMENT ADVISOR

DENEWILER

Capital Management Inc.
1600 Stout Street
Suite 1690
Denver, CO 80202

303.832.7475 / 888.808.7475
Fax 303.832.7484
greg@growmydollar.com
www.growmydollar.com

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OBSERVATIONS ON THE MARKET

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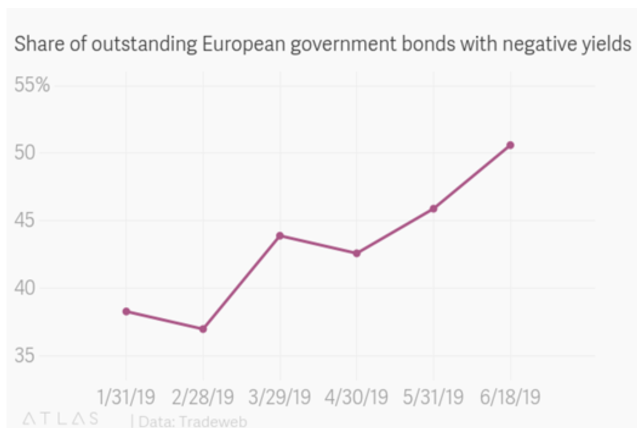
By Greg Denewiler, CFA

They say that a picture paints a thousand words, well this one paints 12 trillion. According to the Financial Times, this is how much total debt there is in global markets, which has a negative yield. In Switzerland, you must pay them if you want to invest in 96% of their debt. In Germany, it is 88%. If you want to buy a 10-year German bond, you must buy the interest rate as well. At the end of 10 years, you will be paid back less than you invested 10 years earlier. This is the result of half of all European government debt being a profit source for their governments. What a concept – The more they borrow, the more money they make. This has even carried over to 20% of the European investment grade debt market. The obvious question is; how did this happen? Simple answer - European Central Banks have been big buyers. Even more amazing; they have stated in the last few days they may be buying more. The US is one of the few major economies that does not have a negative interest rate, thanks in part to our stronger economy than the rest of the world. What does this mean for investors?



You are not alone if your first thought is not a good one. What happens if the global economy slips into a recession? What tools do these central bankers have left to use? They have already created free money. Before you suggest that this is obviously the calm before the global depression, predictions are useless if you are off by 5 or 10 years. Everyone has missed the stock market strength and the seemingly terminally low interest rates of the past 10 years. Predicting the next 5 or 10 years is probably going to be just as futile.

It is a balancing act. The market loves lower interest rates to a point. Just like lower interest rates allow you to afford a larger house with the same payment, lower rates also make the earnings of a company worth more. However, there is a point where lower interest rates are the result of a slowing economy, or even a recession. If the economy slows too much, however, it then affects corporate earnings, which the stock market doesn't like. For the moment, investors feel the Fed is acting proactively to prevent the economy from slowing, so they love lower interest rates. If you are confused, so is everyone else.

Lower interest rates have not seemed to help Europe much. Allowing companies to borrow money for free hasn't seemed to stimulate their economy. Regulations and tariffs are an entirely different matter. Your view of tariffs is most likely dependent on your political views. Did they work with Mexico? Depends on who you ask. You see the risk of waiting for clarity, the market reacts immediately with any hint of a resolution, real or otherwise. It would appear the bigger risk currently is investing in longer maturities or lower quality bonds. With rates so low, a recession will kill lower credit quality bonds. The global bond markets are in uncharted waters, which means no one knows what the ending looks like. There seems to only be one reason to invest in a German bond for 10 years knowing you will lose money. Yields may go even lower in the short-term which makes the bonds worth more money before you eventually lose it. It's the long-term sustainable cash flow that matters.