Beacon Trust

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Global Interest Rates: U.S. Yields May Appear Low, But…

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As indicated in the table on the next page, the 2.301% yield on 10-year maturity U.S. Treasury notes ranks about mid-way in this list of selected global issuers. You will note that U.S. rates are generally higher than in most countries in the Euro-zone, as well as in Japan. Alan Segars, Beacon Trust's Chief Investment Officer, cites the weak economy and very low inflation/threat of deflation in those areas as reasons for the very low yields. Another striking feature of the data in the table is the fact that credit ratings are not necessarily correlated with market yields as one might expect, in that higher credit ratings do not automatically correspond to lower yields, and vice-versa. (Note, for example, Aaa/AA rated New Zealand at 3.972% and lower Aa3/AA-rated Japan at 0.442%.)

These statistics offer several considerations for domestic U.S. fixed-income investors. In this situation where the maturity is a constant 10 years for all issuers, one of the few other ways to increase yield is typically to decrease credit quality. Also, since the European Central Bank (ECB) and the Bank of Japan (BOJ) are currently in a more accommodative policy stance than the U.S. Federal Reserve, lower Euro-zone and Japanese rates might have a moderating influence on how much U.S. rates may eventually rise, since U.S. yield levels already appear attractive to many overseas investors. Finally, the percentage change in income from taking more credit risk may seem significant since absolute levels are so small: selling U.S. at 2.301% and buying Australia at 3.191% is an increase of 38.7%. However, the additional monthly income of about $74 per $100,000 invested might not be considered significant in some cases.

The historically extreme nature of some of these yield differentials is shown by a comparison of U.S. and German 10-year maturity Sovereign yields. Over the past 25 years, German rates have decreased almost 3 full percentage points more than U.S. rates and, in the process, have rewarded investors in German bonds (the price rose as the yield declined) and reduced the German government's interest expense versus that of the U.S.

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Market Facts

1) U.S. rates are generally higher than in most countries in the Euro-zone, as well as in Japan.
2) Lower Euro-zone and Japanese rates *might* have a moderating influence on how much U.S. rates *may* eventually rise.
3) Investing in non-U.S. Dollar denominated securities also entails exchange rate risk and sovereign risk.

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Selected 10-Year Maturity Sovereign Note Yields and Credit Ratings
(as of 11/25/14)

#	Issuer	Yield (%)	Credit Ratings Moody's	S & P
1	*Greece*	*7.717*	*Caa1*	*B*
2	Brazil	4.048	Baa2	BBB-
3	New Zealand	3.972	Aaa	AA
4	Colombia	3.585	Baa2	BBB
5	Mexico	3.305	A3	BBB+
6	Australia	3.191	Aaa	AAA
7	*Portugal*	*2.902*	*Ba1*	*BB*
8	South Korea	2.656	Aa3	A+
9	**United States**	**2.301**	**Aaa**	**AA+**
10	Italy	2.149	Baa2	BBB
11	United Kingdom	2.011	Aa1	AAA
12	Canada	1.982	Aaa	AAA
13	Spain	1.930	Baa2	BBB
14	France	1.082	Aa1	AA
15	Sweden	1.058	Aaa	AAA
16	Netherlands	0.885	Aaa	AA+
17	Germany	0.756	Aaa	AAA
18	Japan	0.442	Aa3	AA-
19	Switzerland	0.351	Aaa	AAA

Source: Bloomberg
Issuers in italics have Below Investment Grade (BIG) credit ratings.

Conclusions for investors:

1. Lower Euro-zone and Japanese rates could help to keep U.S. yields lower than might otherwise be anticipated;
2. The U.S. dollar could benefit from higher yields here attracting foreign investors; and,
3. U.S. investors need not take currency risk and foreign Sovereign credit risk to obtain relatively high yields—they can buy U.S. Treasuries.

As always, investing in non-U.S. dollar-denominated securities also entails exchange rate risk (the value of the investment may decline in terms of the U.S. dollar) and Sovereign risk (the stability and policies of the issuing government could change for the worse).

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