

HOW ONE MIGHT BEAT NEGATIVE GOVERNMENT-BOND YIELDS

Is it still possible to earn money with Eurozone government bonds? We think so: Steep yield curves can serve as a medicine against negative interest rates.

Yields on German sovereign bonds have dropped deeply into the red. Investors nowadays have to tie up their money for decades in order to secure a positive return over the entire term. Of course, negative yields make life easier for the finance ministers of Germany and many other developed countries in Europe and beyond. For investors, however, waiting so long for even the most meager nominal return it can be a deeply depressing experience. But there is good news: even when interest rates are below zero, strategies exist that may help to escape the negative yield trap.

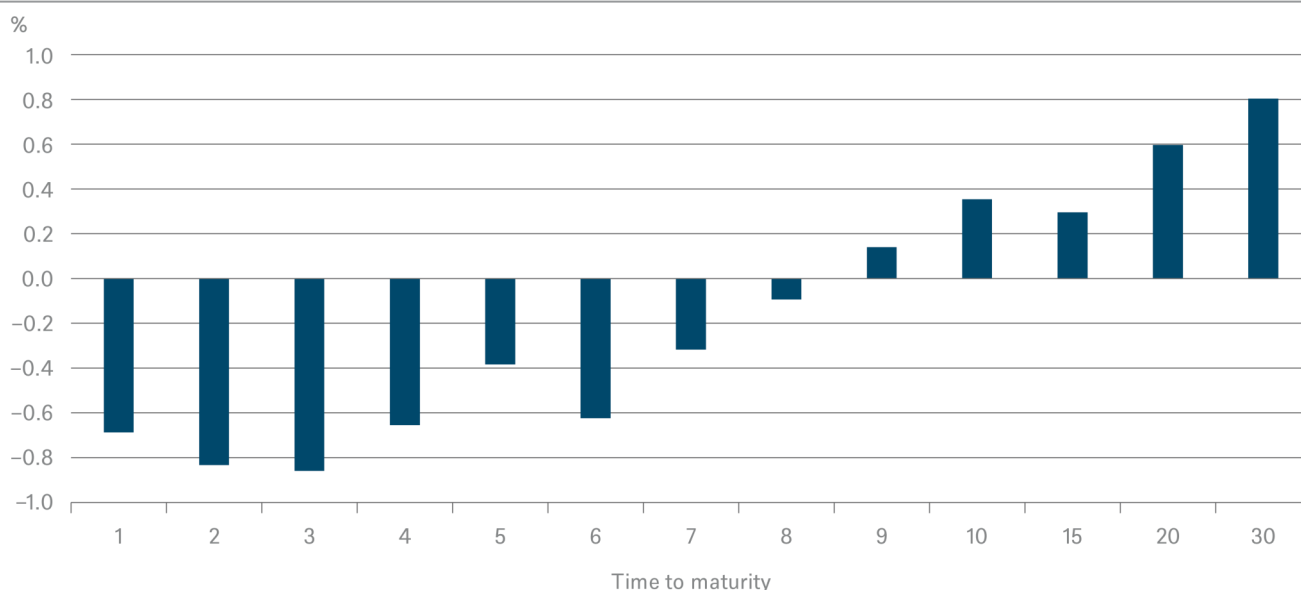
One way is depicted in our "Chart of the Week". We take a look at the performance one can expect when buying a German sovereign bond and holding it for just one year, instead of keeping it until maturity. In 12 months, a 10-year bond that currently yields -0.40% will turn into a 9-year bond. The latter trade at -0.49%, meaning that one can achieve a price gain on the sale that would overcompensate for the negative yield.

Naturally, this calculation is highly dependent on where

yields go over the next year. For our consideration, we have assumed that the entire yield curve does not move for 12 months. Although this hypothesis is unrealistic, it can be assumed that yields can rise as well as fall, so that the result of the calculation could be worse as well as better.

Does this theoretical consideration also work in practice? Let's take a look at Japan. There, yields on 10-year government bonds fell into negative territory in February 2016. On average, 10-year bonds have since traded at a meager yield of just 0.011%. However, according to ICE Data Services, the average annual performance of indices tracking 7 - to 10-year Japanese government bonds was +0.46% since February 2016.

Japan proves that strategies exploiting the steepness of the yield curve have also worked in practice, emphasizes Johannes Müller, Head of Macro Research at DWS. Finally, the question arises as to who picks up the bill? Here, too, our "Chart of the Week" has the answer: Investors who hold short-dated bonds have to digest price declines in addition to negative returns.



■ 12-month performance of German government bonds*

* assuming a constant yield curve.

Past performance is not a reliable indicator of future returns. Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 7/31/19.

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Source: DWS Investment GmbH

APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

	06/14 - 06/15	06/15 - 06/16	06/16 - 06/17	06/17 - 06/18	06/18 - 06/19
Japan 7-10yr	1.7%	6.0%	-2.4%	0.7%	2.0%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 7/31/19

GLOSSARY

Maturity

The final payment date of a financial instrument is its **maturity**.

Sovereign bonds

Sovereign bonds are bonds issued by governments.

Yield curve

A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

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CRC 069531 (08/2019)

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