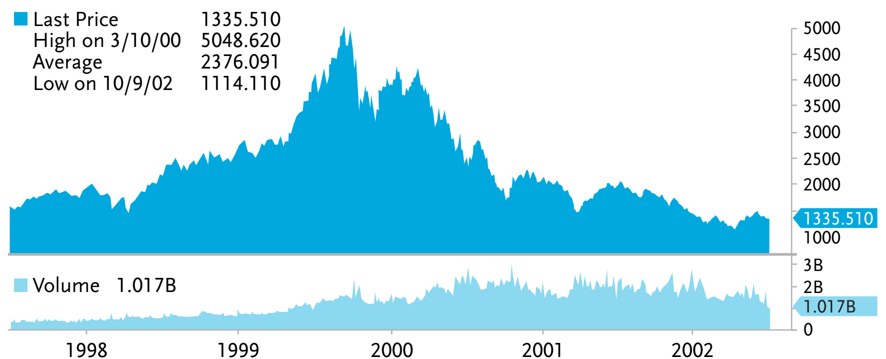
VIEWPOINT

# Move Over FOMO, Here Comes FONONYA

**JERRY CUDZIL** | 16 JULY, 2019

FOMO is a well-known and widely-used acronym: Fear of Missing Out. This is the behavioral aspect of investing that would lead an investor to buy or sell a security because they want to experience the same return as other investors. It is when an investor decides to make an investment not because she believes in the underlying fundamental value of the investment but because the investor fears on missing out on the potential return that investment may generate. Maybe Investor A missed out on a fanciful return of a high-flying IPO. What is Investor A to do? Well, buy the next high-flying IPO, regardless of price, of course! Ultimately, the greater fool theory runs its course and the last investor, usually the investor that pays the highest price, ends up with the largest loss. For those investors that were around during the Internet boom (and subsequent bust) of 1999-2001 that stove probably still feels pretty hot. The NASDAQ peaked at 5041 in March of 2000 and FOMO was in full effect. The old-school metrics of cash flow multiples determining asset coverage were replaced by "clicks and eyeballs." It seemed like the only mistake was not buying the internet stocks and high-flying IPOs. One year later the NASDAQ was down ~67%. The index wouldn't reach the level seen in 2000 for 15 years.

**NASDAQ Composite: Inflation and Bursting of the Burst Dot Com Bubble**



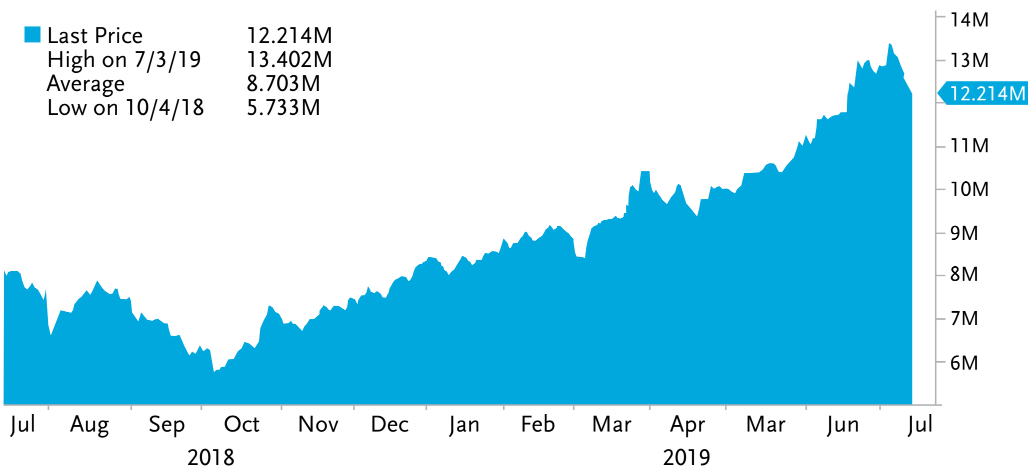

Source: Bloomberg

**Jerry Cudzil**
Managing Director
Head of Credit Trading
Fixed Income

Mr. Cudzil is a Specialist Portfolio Manager and head of Credit Trading. He oversees the Fixed Income group's trading of investment grade corporate bonds, high yield bonds, leveraged loans and credit derivatives. Prior to joining TCW in 2012, Mr. Cudzil was a High Yield Bond Trader for Morgan Stanley and Deutsche Bank, specializing in project finance, aviation, and energy securities. He was previously a Portfolio Manager for Dimaio Ahmad Capital, managing the multi-strategy credit fund and aviation fund and leading the firm's risk management team. Mr. Cudzil began his career as a Corporate Bond Trader for Prudential Securities and has also traded investment grade and high yield debt for Credit Suisse and Goldman Sachs. Mr. Cudzil earned a BA in Economics from the University of Pennsylvania.

So, why the digression and what is this new acronym that doesn't exactly roll off the tongue? The new and improved acronym describes the recent phenomenon of investing in negative yielding assets. FONONYA is the **F**ear **O**f **N**ot **O**wning **N**egative **Y**ielding **A**ssets. Up until 10 years ago it would be unthinkable for someone to buy a negative yielding asset. I think everyone and anyone in the investing community would have looked at you like you had lost your mind. Who would buy negative yielding assets? It was a short 35 years ago that people were taking on double-digit liabilities. It would not be uncommon for someone to take out a mortgage with a yield of 13-15%. Current coupon mortgages in 1985 were above 12%; today they sit just below 3%. But historical taboo and higher historical mortgage rates have not dampened the enthusiasm for negative yielding debt. The world is awash in negative yielding debt. Today, over $12 trillion of debt is yielding below ZERO. In fact, almost 25% of the $50+ trillion Bloomberg Barclays Global Aggregate Bond Index is yielding below ZERO (chart below).

**Negative Yielding Debt in the Bloomberg Barclays Global Aggregate Bond Index**




Source: Bloomberg

Have investors completely lost their mind? Maybe not. There are multiple reasons why investors might find themselves buying negative yielding assets:

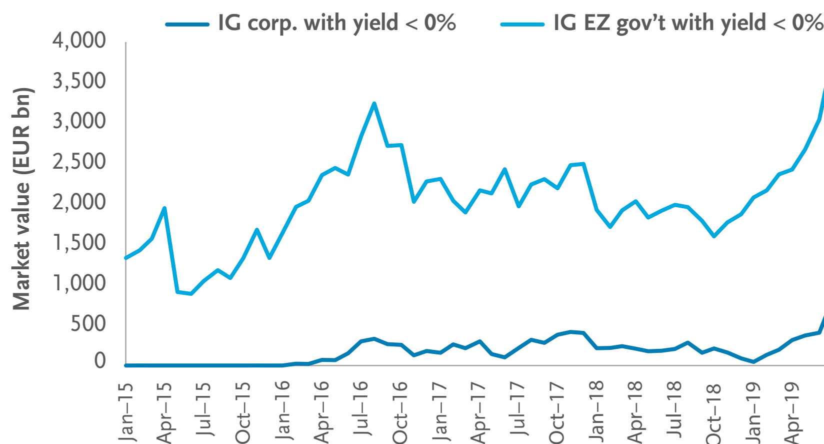
- Deflation concerns: the negative return of the asset purchased will protect me against a more significant fall in other assets or goods
- Central banks: central banks' manipulation of rates into negative territory creates an environment where it is rational for investors to buy negative yielding securities, if by doing that investors are able "pick yield," buying an asset with a less-negative yield than the market
- Currency Hedged Returns are higher: investors might buy a bond with a negative yield in currency A but might then swap that bond into currency B; the currency swap enhances the return
- Index Tracking funds: some funds track and/or replicate an index with bonds that have negative yields and will buy the bonds to manage tracking error

This list is neither meant to be exhaustive nor supportive of buying bonds with a negative yield but simply to highlight potential rationale. In the past week, Germany has executed something once believed unthinkable: selling 10yr bunds via auction with a ZERO percent coupon that yielded negative -.24% at issue. Yes, if investors hold that newly minted German bund for the next 10 years they will be guaranteed to lose money.

This phenomenon doesn't stop at government bonds with negative yields. Today there is over $700 billion in negative yielding corporate debt in the marketplace, including a quarter of all investment grade Euro bonds. Yes, the markets have grown significantly over time but this is not only the highest nominal amount of negative yielding corporate debt on record but also the highest percentage on record as well.

**Negative Yielding Euro IG Corp and Sov Debt**

**Market value** of IG bond index members (subset of full bond universe) with a **negative yield** (ask side)...




Source: Deutsche Bank, Market (calculations based only on bonds included in iBoxx indices)

**Negative Yielding European Credits**

Share of EUR corporate bonds with yield < 0%

| | 1-2 | 2-3 | 3-4 | 4-5 | 5-6 | 6-7 | 7-8 | 8-9 | 9-10 | 10-20 | 20-30 | **1-30** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| AAA | — | 100% | — | 100% | — | — | 0% | — | 0% | 0% | — | **38%** |
| AA | 100% | 100% | 98% | 77% | 67% | 44% | 0% | 0% | 0% | 0% | — | **67%** |
| A | 92% | 85% | 70% | 35% | 13% | 2% | 1% | 2% | 0% | 0% | — | **37%** |
| BBB | 77% | 56% | 25% | 14% | 4% | 0% | 0% | 0% | 0% | 0% | 0% | **22%** |
| BB | 32% | 3% | 2% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | — | **9%** |
| B | 15% | 0% | 0% | 0% | 0% | 0% | 0% | — | — | — | — | **6%** |
| IG | 86% | 74% | 51% | 28% | 11% | 5% | 0% | 1% | 0% | 0% | 0% | **33%** |
| | | | | | | | | | **EUR IG 1-30y market value** | | | **2.2tn** |

Source: Deutsche Bank, Bloomberg Finance LP

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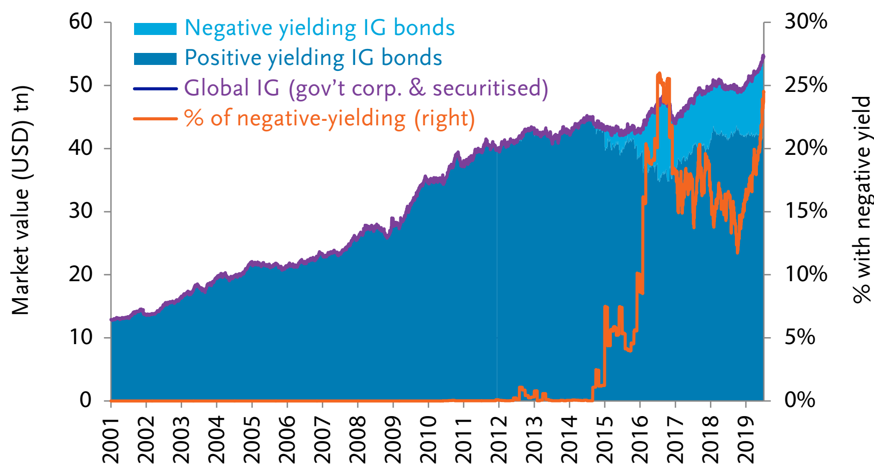
**Negative Yielding Global IG Bonds**

**$13.4tn of global IG** bonds have a **negative yield (24.5%** of the $54.6tn total)




Source: Deutsche Bank, Bloomberg Finance LP
Data services used: Bloomberg Barclays Global Aggregate Bond Index

Some would argue that this is rational. After all, government bond yields have dipped solidly into negative territory and investors are still receiving a spread to the risk-free rate to buy a risky asset. Seems logical. If central banks pull interest rates further into negative territory and again buy corporate bonds, one could see yields trade further into negative territory; producing a positive return on this negative yielding cohort of securities! Clearly this has to be limited to government bonds and only the highest rated corporate bonds. The answer is of course yes......mostly. Last week we observed 14 below investment grade issuers with negative yields in Europe. Are there mitigating circumstances with some of these bonds? Yes. Some are callable and trading negative yield to call. And this is currently only 2% of the Euro HY market and may be too small of a cohort to contain any information.

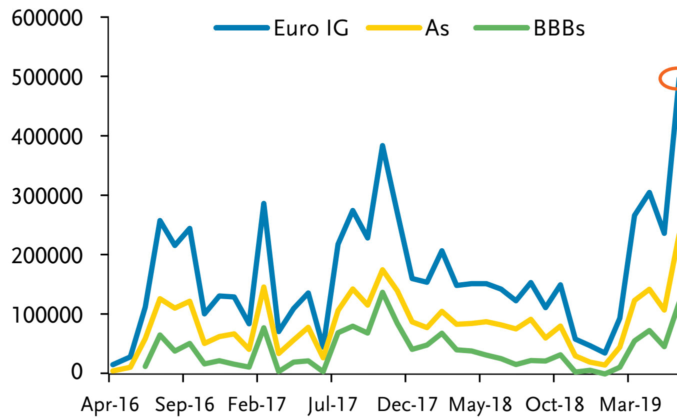
### What does it all mean?

Clearly investors think that central banks are failing to stimulate inflation. Inflation expectations are low for the foreseeable future. Drawing a conclusion from their actions, it is also clear central banks think that the cure to low inflation expectations is lower rates. This has not only distorted pricing in government securities but has now begun to further distort corporate bond prices. The longer market prices do not reflect value but reflect distortions created by central banks, the higher the likelihood that the inevitable fall in prices will be that much more damaging.

Negative yielding corporate debt empirically implies negative loss expectations. Even if deflation expectations explain negative yields in principle, it is difficult, one might argue impossible, to see why such deflationary expectations would support negative yields on corporate bonds. Lastly, deflationary expectations are typically synonymous with weak economic growth; not exactly supportive for corporate credit either. No matter the reason it seems that one easy conclusion from all this is that buying negative yielding high yield bonds is a bad idea.

**Share of Negative Yielding Euro-Denominated Bonds**

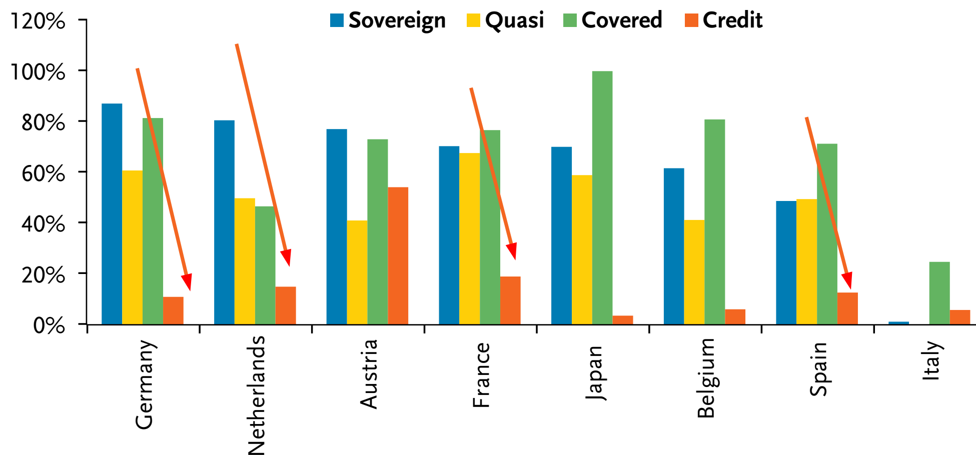
A record €500bn+ of negative yielding credit (~25% market)




Source: BofA Merrill Lynch, ICE Data Indices LLC. Eur mn volume of negative yielding corp bonds.

**Share of Negative Yielding Japanese Bonds**

Percentage of different market segments yielding below zero (GFIM index)




Source: BofA Merrill Lynch, ICE Data Indices LLC. % of a sector trading negative yielding. High-grade credit only.

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