WTF? – A private placement at negative interest rates?

The end of the financial year draws near and no doubt everyone will be reviewing their results. But do you ever stop and look further back at where you've been, and where you have come from? No doubt you do, it's natural, and as investors I'm sure you do this regularly. But I sometimes wonder whether our central bankers do?

If I had said to you in June of 2006, that in June 2016 the Australian 10 year bond rate would be ~2.0%, and that the cash rate would be 1.75% you'd say I was crazy. If I also said, that despite these record low levels, Australia would enjoy one of the highest levels of economic growth in the OECD over the same period, and continues to outperform many of its peers - you'd have me committed.

Why I am I raising this point? Last week a seminal moment occurred in this great global monetary experiment of the last 10 years. In capital markets terms it was a very small transaction (AUD 121m), but we do stop and question its meaning. CostCo Japan issued a 5 year bullet loan in the US private placement (USPP) market at a yield of **minus 10bp** (yes, that figure is correct).

We have of course heard of a number of large corporates issuing bonds in public markets at near zero yields (e.g. Toyota), and of course then there are the 60% of the world's sovereign bonds trading with negative yields. If you trade in these securities, I think I understand why you hold them – you're just waiting for the next central bank buying spree to capture the capital gain. That is, investors aren't buying negative yielding bonds on a 'buy and hold' basis – they are buying them to speculate.

But secondary trades in the US Private Placement market occur infrequently. Its participants are typically large pension funds and insurers who participate on a buy and hold to maturity basis – they are asset liability matching investors. Sure, positions trade, but it's irregular. Why would anyone invest in this illiquid negative yielding instrument? Perhaps the cross-currency basis makes the opportunity attractive for the end investor. But more importantly – it shows that as a corporate in Japan you can be paid to borrow!

To us it begs the question as to where this (the monetary experiment) is all going, but more importantly, how does it unwind? The implications are significant for all long-term investors as well as all investors in long-duration assets.