

CHART OF THE DAY

August 17, 2018

Spotlight on : 10-2 Yield Curve

A key metric to follow is the relationship, i.e., the spread, between the 10-Year U.S. Treasuries yield and the 2-Year U.S. Treasuries yield.

A widening spread denotes bullishness and economic growth expectations, while a declining spread that goes negative (or inverts) signifies slowing economic growth and, even, the likelihood of a recession.

For clarity, a negative or inverted yield curve indicates that long-term debt instruments have a lower yield than short-term debt instruments, given that these debt instruments are of the same or similar credit quality.

Historically, inversions of the yield curve have preceded many U.S. recessions. Thus, the yield curve is considered an important barometer for predicting turning points in the business cycle.

COMMENT: *There is growing angst among many market pundits that the U.S. Federal Reserve will have increasing difficulty fending off the risk of recession as inflation rises against the back-drop of: an economy at near capacity; with unemployment at decade lows; of two+ years of consecutive quarterly earnings and revenue beats/gains such that, going forward, positive comparisons will become more difficult to achieve; with interest rates on the rise; and with tariff threats infecting global trading arrangements resulting in consequential investment uncertainty.*

COMMENT: *As shown in the following charts, the 10-2 yield curve currently is well above the 0.0x inversion level. However, the yield-curve ratio continues to decline. There is no need for panic yet; an imminent recession is not in the cards. The charts below are for the following periods: (1) 5-year (August 2013-August 2018); (2) 2018 (January-August); and (3) since January 2000.*

(1) 5-Year (August 2013-August 2018)

As shown on the five-year chart below, the trend is decidedly down, as it is well below the long-term, larger, **black** down-trend line. The **rust** down-trend line represents the trend for 2018 where the high point was reached on February 9, 2018. This down-trend line is shown in the next chart.



(2) Seven-and-a-Half Months – (January 1, 2018 – August 16, 2018)

In 2018, after reaching a high of 0.78x on February 9, the ratio declined to 0.41x on April 17. It rose over the next month to 0.54x on May 17 and has been in free-fall pretty much since, ending August 16 at 0.24x (the end of this chart) and to 0.26x on August 17 (not shown on the chart).

For comparison, Canada’s 10-2 yield curve ratio on August 17 was 0.17x.



(3) Since January 1, 2000

Here is a look at the 10-2 yield curve going back to January 2000. It shows the negative occurrences (below 0.0x) and the corresponding recessions that soon followed. Currently, despite the falling trend-line, there is still quite a ways to go to reach the inversion level and the possibility of a resulting recession. The **black** and **rust** down-trend lines are the same as those drawn on the previous charts.



COMMENT: *We are experiencing the second-longest stock market up-trend in history, so it is natural to expect, eventually, that the economy will fall into recession. As the long-term chart above shows, once the 10-2 yield curve goes negative, an economic recession soon follows. But, it is not coincidental. And, it can give a false positive: see early 2006 in the chart above. Despite the discouraging down-trend that is occurring, U.S. economic growth still continues positively and, therefore, the possibility of a near-term recession in the United States seems remote at this point. However, we will continue to monitor closely that downward trend.*

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