

CHART OF THE DAY

September 21, 2018

Spotlight on : 10-2 Yield Curve

COMMENT: *The spreads for both the U.S. and Canadian 10-year to 2-year yields moved up this past week, 5 basis points and 6 basis points respectively. They rose from 0.21x to 0.26x for U.S. Treasury spreads and from 0.18x to 0.24x for Canadian spreads. On Tuesday, the U.S. 10-year yield, for the second time this year, rose above the 3.00% mark, which was deemed to be a cautionary level by many pundits. However, at a Friday level of 3.07%, it seems that the equity market has been able to take the plus-3.00% level in stride. Nevertheless, it is clear that rates are rising. With inflation also becoming more buoyant, albeit only slightly, there is reason to begin being more cautious towards the equity market. The ten-year bull may not be over yet in the United States in light of the continuing strong corporate earnings performance and the strong economic performance by many indicators, but becoming more defensive in one's equity portfolio might be advisable.*

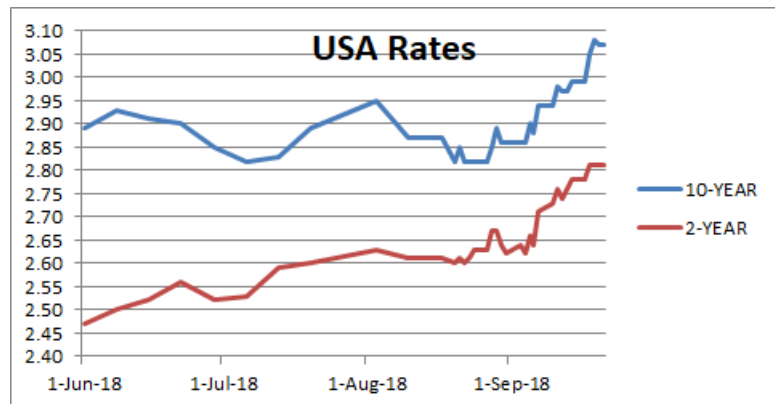
- The ratio of 10-year U.S. Treasury yields to 2-year U.S. Treasury yields on Friday, September 21 stood at 0.26x up from 0.21x a week ago. On June 1, the spread was 0.42x and, at the end of 2017, it was 0.51x.
- From June 1 until September 1, the 10-year U.S. Treasuries yield moved basically sideways. Since September 1, the yield has been rising, from 2.86% to the current 3.07%. The 2-year yield has been rising since June 1, from 2.47% to 2.81%.
- In Canada, the spread on Friday, September 21 was 0.24x up from 0.18x a week ago. On June 1, it was 0.43x, and was 0.34x at year-end 2017.
- Canadian rates have been slightly more erratic since June 1 but have not risen overall as much as in the USA. 10-year Canadas are up from 2.33% to the current 2.42%. The 2-year yield has been rising slowly since June 1, from 1.90% to the current 2.18%.
- For 2018, the yield curve in both the USA and Canada has been declining, until September. Since then, it has been rising slightly.
- A declining spread that approaches 0.00x or that actually goes negative (or inverts) signifies slowing economic growth and, even, the likelihood of a recession.

- A recession usually occurs a few months after the yield curve inverts (see the long-term chart on page 5).
- Sometimes, a negative yield curve gives a false positive (again, see the long-term chart).
- 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.

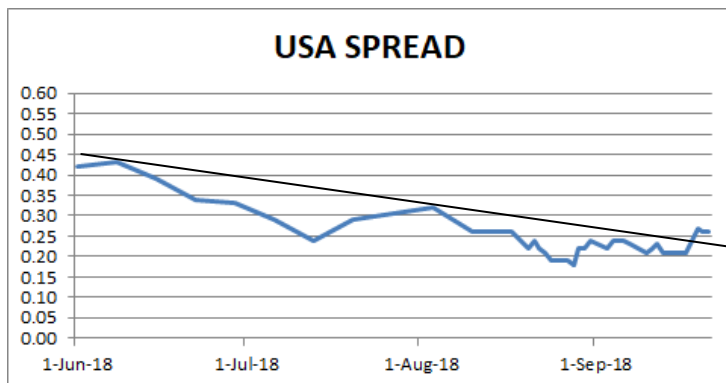
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U.S. Treasuries 10-2 Yield Ratio

<u>DATE</u>	<u>10-YEAR</u>	<u>USA</u> <u>2-YEAR</u>	<u>DIFF</u>
1-Jun-18	2.89	2.47	0.42
8-Jun-18	2.93	2.50	0.43
15-Jun-18	2.91	2.52	0.39
22-Jun-18	2.90	2.56	0.34
29-Jun-18	2.85	2.52	0.33
6-Jul-18	2.82	2.53	0.29
13-Jul-18	2.83	2.59	0.24
20-Jul-18	2.89	2.60	0.29
3-Aug-18	2.95	2.63	0.32
10-Aug-18	2.87	2.61	0.26
17-Aug-18	2.87	2.61	0.26
20-Aug-18	2.82	2.60	0.22
21-Aug-18	2.85	2.61	0.24
22-Aug-18	2.82	2.60	0.22
23-Aug-18	2.82	2.61	0.21
24-Aug-18	2.82	2.63	0.19
27-Aug-18	2.82	2.63	0.19
28-Aug-18	2.85	2.67	0.18
29-Aug-18	2.89	2.67	0.22
30-Aug-18	2.86	2.64	0.22
31-Aug-18	2.86	2.62	0.24
3-Sep-18	2.86	2.64	0.22
4-Sep-18	2.86	2.62	0.24
5-Sep-18	2.90	2.66	0.24
6-Sep-18	2.88	2.64	0.24
7-Sep-18	2.94	2.71	0.23
10-Sep-18	2.94	2.73	0.21
11-Sep-18	2.98	2.76	0.22
12-Sep-18	2.97	2.74	0.23
13-Sep-18	2.97	2.76	0.21
14-Sep-18	2.99	2.78	0.21
17-Sep-18	2.99	2.78	0.21
18-Sep-18	3.05	2.81	0.24
19-Sep-18	3.08	2.81	0.27
20-Sep-18	3.07	2.81	0.26
21-Sep-18	3.07	2.81	0.26



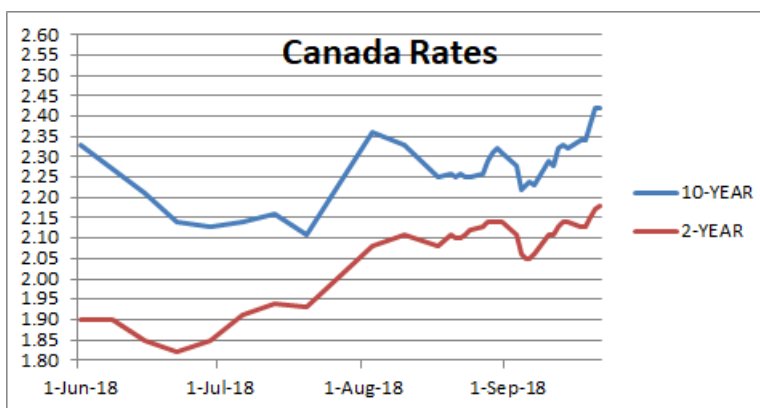
The U.S. Treasuries 10-2 spread has risen recently and has broken above its down-trend line:



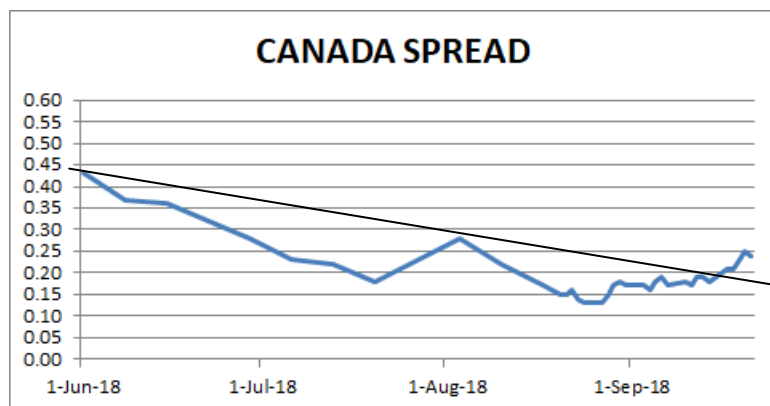
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Canadas 10-2 Yield Ratio

<u>DATE</u>	<u>10-YEAR</u>	<u>CANADA</u> <u>2-YEAR</u>	<u>DIFF</u>
1-Jun-18	2.33	1.90	0.43
8-Jun-18	2.27	1.90	0.37
15-Jun-18	2.21	1.85	0.36
22-Jun-18	2.14	1.82	0.32
29-Jun-18	2.13	1.85	0.28
6-Jul-18	2.14	1.91	0.23
13-Jul-18	2.16	1.94	0.22
20-Jul-18	2.11	1.93	0.18
3-Aug-18	2.36	2.08	0.28
10-Aug-18	2.33	2.11	0.22
17-Aug-18	2.25	2.08	0.17
20-Aug-18	2.26	2.11	0.15
21-Aug-18	2.25	2.10	0.15
22-Aug-18	2.26	2.10	0.16
23-Aug-18	2.25	2.11	0.14
24-Aug-18	2.25	2.12	0.13
27-Aug-18	2.26	2.13	0.13
28-Aug-18	2.29	2.14	0.15
29-Aug-18	2.31	2.14	0.17
30-Aug-18	2.32	2.14	0.18
31-Aug-18	2.31	2.14	0.17
3-Sep-18	2.28	2.11	0.17
4-Sep-18	2.22	2.06	0.16
5-Sep-18	2.23	2.05	0.18
6-Sep-18	2.24	2.05	0.19
7-Sep-18	2.23	2.06	0.17
10-Sep-18	2.29	2.11	0.18
11-Sep-18	2.28	2.11	0.17
12-Sep-18	2.32	2.13	0.19
13-Sep-18	2.33	2.14	0.19
14-Sep-18	2.32	2.14	0.18
17-Sep-18	2.34	2.13	0.21
18-Sep-18	2.34	2.13	0.21
19-Sep-18	2.38	2.15	0.23
20-Sep-18	2.42	2.17	0.25
21-Sep-18	2.42	2.18	0.24



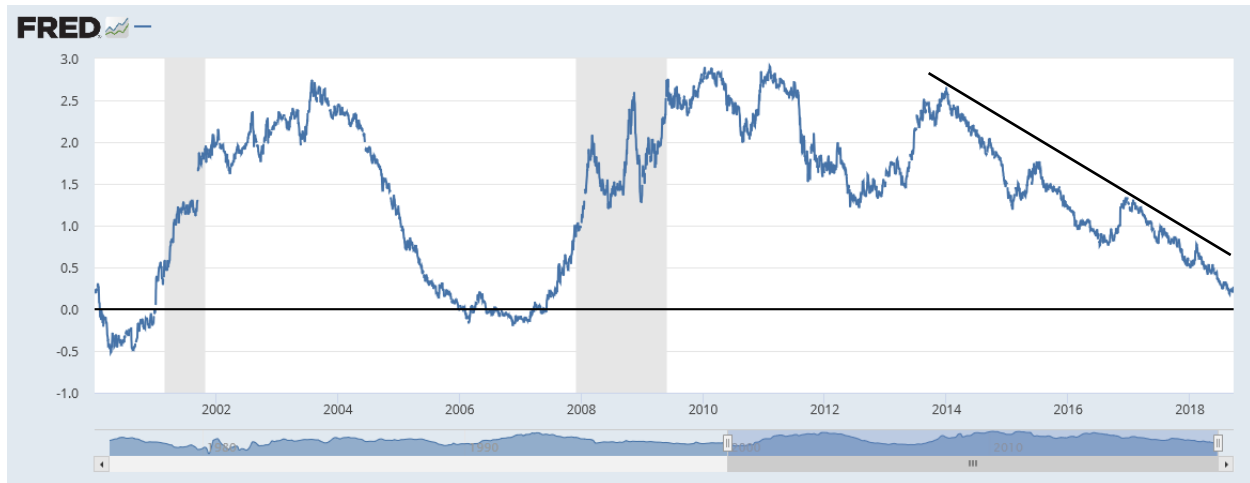
Similarly, the Canadas 10-2 spread has broken above the down-trend line:



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U.S. Treasuries 10-2 Yield Ratio 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 (shaded areas) that soon followed. Currently, despite the falling trend-line, there is still further to go to reach the inversion level and the possibility of a resulting recession. The current ratio is 0.26x, up slightly this past week.



- We are now experiencing the 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, interestingly, the recession occurs well after the yield curve has returned to positive and started a sharp rise. Also, as shown in early 2006 in the chart above, it can give a false positive. 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 still seems remote at this point. However, we will continue to monitor that downward trend.
- 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; unemployment at decade lows; two+ years of consecutive quarterly earnings and revenue beats/gains such that, going forward, positive comparisons will become more difficult to achieve; interest rates on the rise; and tariff threats infecting global trading arrangements and resulting in investment uncertainty.

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