
CHART OF THE DAY

October 5, 2018

Spotlight on : 10-2 Yield Curve

COMMENT: *Interest rates rose dramatically this past week. This scenario finally reflects the recent positive economic trends occurring in the USA. Inflationary measures, such as Producer Prices, Consumer Prices, and Personal Consumption all recently hit cycle highs. The U.S. Treasuries 10-year yield rose from 3.05% to 3.23% this past week. The 10-year/2-year yield spread rose from 0.24x to 0.35x. This level is far from the 0.00x benchmark that warns of a possible recession. In Canada, the rise in rates was not as dramatic, with 10-year Canadas rising from 2.41% to 2.55% and the 10-year/2-year yield spread rising from 0.22x to 0.25x. The questions now become: (1) how much longer will rates rise?, and (2) how high will they go? Regardless, the pressure is off, for now, of watching the yield spread continually decline and move in sight of that 0.00x benchmark. We iterate our previous comments: (1) there is no evidence to suggest that there is a need to fear a recession starting in 2018, particularly with continuing strong corporate earnings performance and strong economic performance by many indicators; and (2) the ten-year equity bull market may not be over yet in the United States, but starting to become 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, October 5 stood at 0.35x up significantly from 0.24x 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 3.23%. The 2-year yield has been rising since June 1, from 2.47% to 2.88%.
- In Canada, the spread on Friday, October 5 was 0.25x up from 0.22x 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 2.55%. The 2-year yield has been rising slowly since June 1, from 1.90% to the current 2.30%.
- For 2018, the yield curve in both the USA and Canada had been declining, until September. Since then, it has been rising slightly until this past week when it rose substantially in both the USA and Canada. This ameliorates the non-recessionary outlook for the near-term.

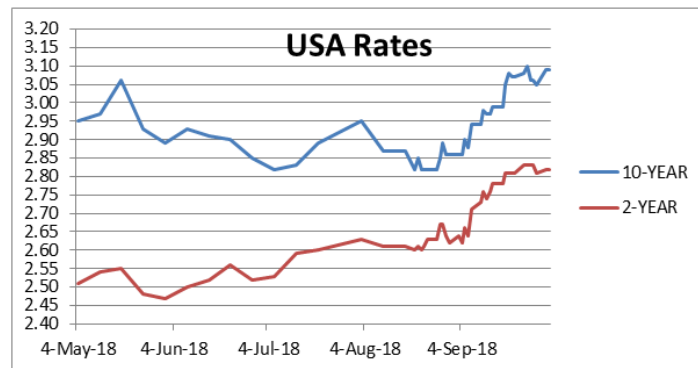
- A declining spread that approaches 0.00x or that actually goes negative (or inverts) signifies slowing economic growth and, even, the likelihood of a recession.
- A recession usually occurs a few months after the yield curve inverts (see the long-term chart on page 5).
- Sometimes, a negative yield 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.

<continued>

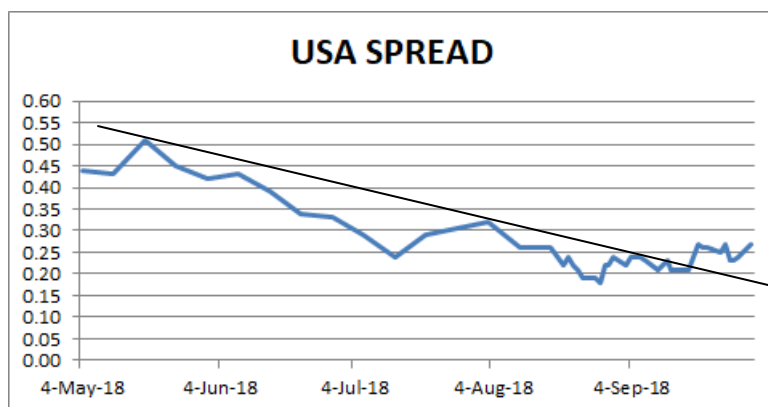
U.S. Treasuries 10-2 Yield Ratio

<u>DATE</u>	<u>10-YEAR</u>	<u>USA</u> <u>2-YEAR</u>	<u>DIFF</u>
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
24-Sep-18	3.08	2.83	0.25
25-Sep-18	3.10	2.83	0.27
26-Sep-18	3.06	2.83	0.23
27-Sep-18	3.06	2.83	0.23
28-Sep-18	3.05	2.81	0.24
1-Oct-18	3.09	2.82	0.27
2-Oct-18	3.09	2.82	0.27
3-Oct-18	3.15	2.85	0.30
4-Oct-18	3.19	2.87	0.32
5-Oct-18	3.23	2.88	0.35

May 1, 2018 - October 5, 2018



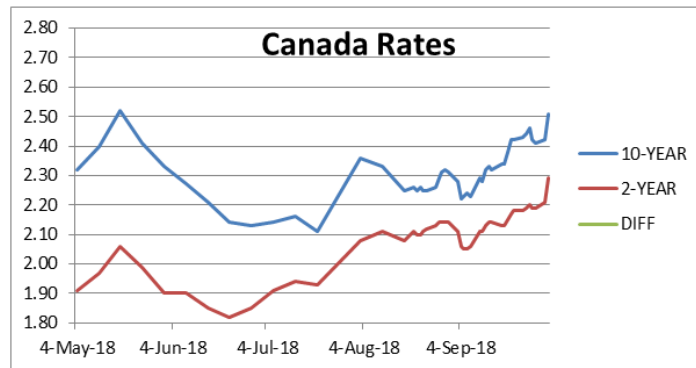
The U.S. Treasuries 10-2 spread continues to rise above its down-trend line:



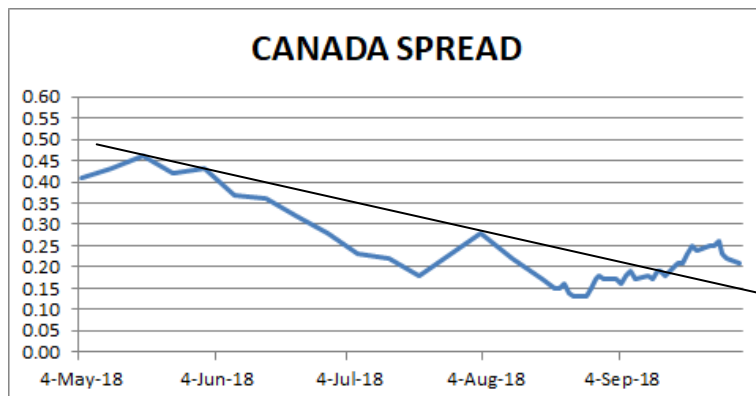
Canadas 10-2 Yield Ratio

<u>DATE</u>	<u>10-YEAR</u>	<u>CANADA</u> <u>2-YEAR</u>	<u>DIFF</u>
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
24-Sep-18	2.43	2.18	0.25
25-Sep-18	2.44	2.19	0.25
26-Sep-18	2.46	2.20	0.26
27-Sep-18	2.42	2.19	0.23
28-Sep-18	2.41	2.19	0.22
1-Oct-18	2.42	2.21	0.21
2-Oct-18	2.51	2.29	0.22
3-Oct-18	2.46	2.27	0.19
4-Oct-18	2.53	2.30	0.23
5-Oct-18	2.55	2.30	0.25

May 1, 2018 - October 5, 2018

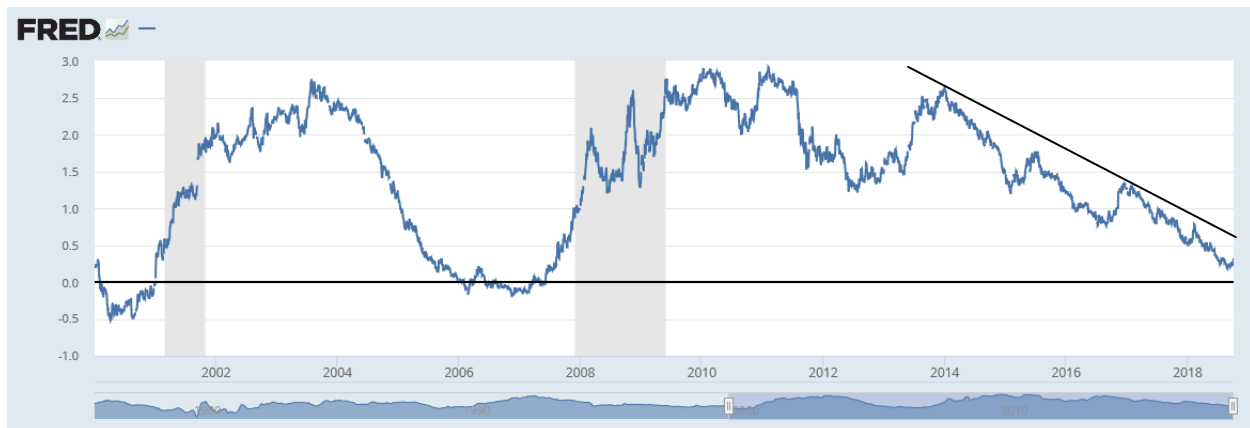


Similarly, the Canadas 10-2 spread continues above the down-trend line:



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 0.35x, well up 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.

***e*RESEARCH DISCLAIMER**

*e*Research is engaged solely in the provision of equity research to the investment community. *e*Research provides published research and analysis to its Subscribers on its website (www.eresearch.ca), and to the general investing public through its extensive electronic distribution network and through newswire agencies.

With regards to distribution of its research material, *e*Research makes all reasonable efforts to provide its publications, via e-mail, simultaneously to all of its Subscribers.

*e*Research does not manage money or trade with the general public, provides full disclosure of all fee arrangements, and adheres to the strict application of its Best Practices Guidelines.