eResearch

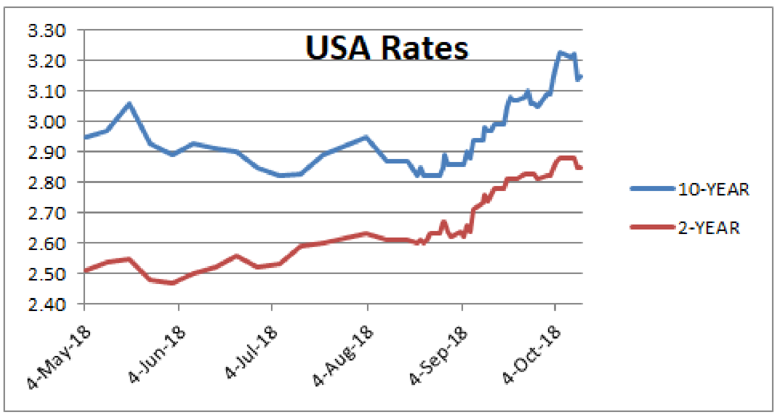
CHART OF THE DAY

October 12, 2018

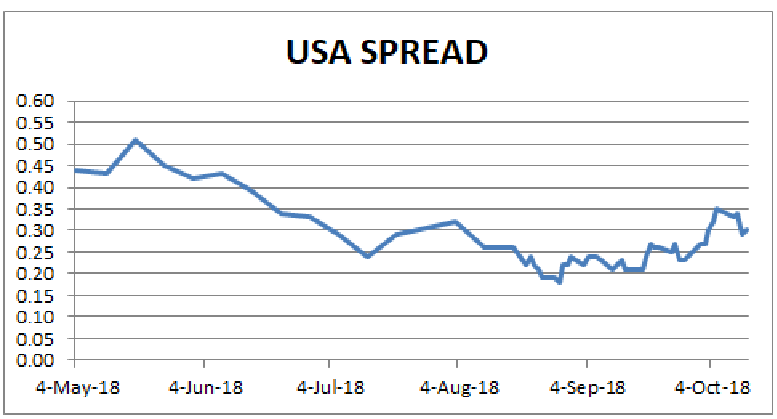
Spotlight on : 10-2 Yield Curve

COMMENT: *In 2018, the yield curve in both the USA and Canada declined until the beginning of September. Since then, it has risen slowly, accelerating the previous week, and declining again this past week. The higher levels soften the recessionary outlook, at least for the near-term.*

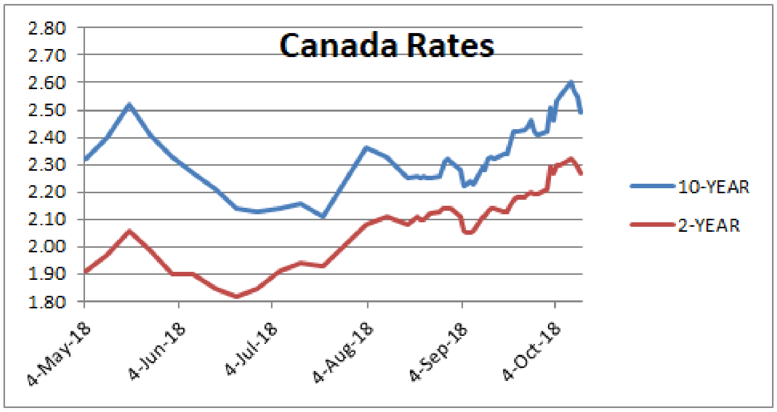
● The 10-year U.S. Treasuries yield has been rising, from 2.86% at the beginning of September to a high a week ago of 3.23%. This past week it ended at 3.15%. The 2-year yield has been rising since June 1, from 2.47% to a high of 2.88% and, currently, it sits at 2.85%.



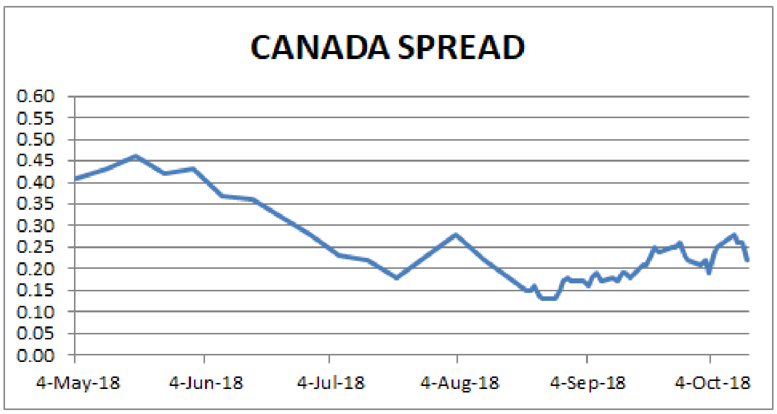
● The ratio of 10-year U.S. Treasury yields to 2-year U.S. Treasury yields on Friday, October 12 stood at 0.30x down from 0.35x a week ago. On May 18, the spread reached 0.51x and, at the end of 2017, it was also 0.51x.



• 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 2.49% having reached a high last week of 2.60%. The 2-year yield has been rising slowly since June 1, from 1.90% to the current 2.27%, having reached a high last week of 2.32%.



• In Canada, the spread on Friday, October 12 was 0.22x down from 0.25x at the end of the previous week. On May 18, it was 0.46x, and was 0.34x at year-end 2017.



• 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 3).

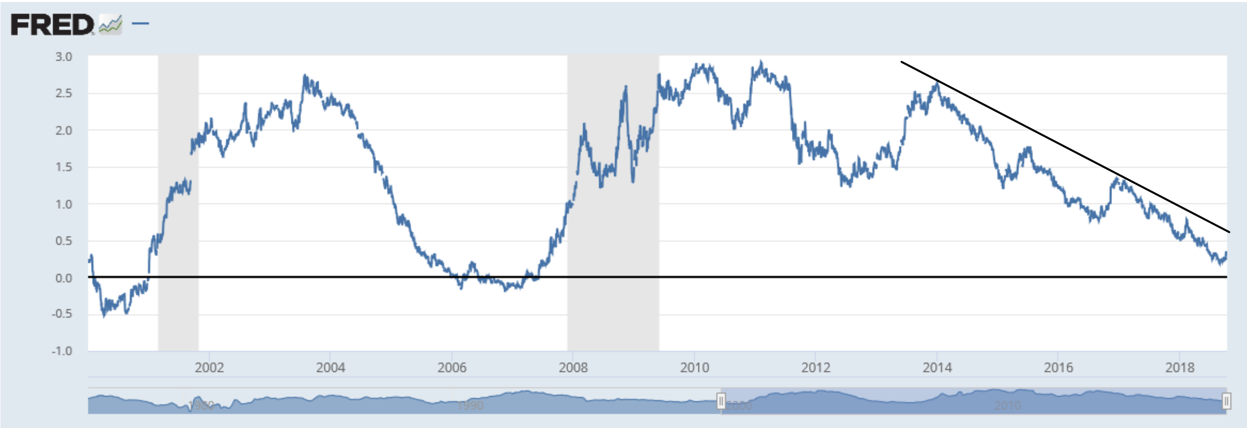
• Sometimes, a negative yield curve gives a false positive (again, see the long-term chart).

• 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.

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 0.30x, down a bit 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 currently 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.

● 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; interest rates on the rise; tariff threats infecting global trading arrangements and resulting in investment uncertainty; and two^{+} years of consecutive quarterly earnings and revenue beats/gains such that, going forward, positive comparisons will become more difficult to achieve.