RECESSION BAROMETER

April 18, 2019

Spotlight on : 10-2 Yield Curve

COMMENT: *Rates moved up this past shortened week, especially in Canada more so than in the USA. Conversely, the "spread" between the 10-year and the 2-year rates widened quite a bit in the USA (at 0.19x) but stayed flat in Canada (at 0.14x). The U.S. 10/2 spread is now back to the higher end of its recent range.*

Our "recession barometer" kicks in when the "spread" between the 10-year rate and the 2-year rate for Treasuries in the USA and Government of Canada Bonds in Canada reaches 0.00x, which means that the yield on the 10s equals the yield on the 2s. If the 10s yield less than the 2s, an "inversion" occurs and then it is likely that a recession will soon follow.

Historically, inversions of the yield curve (the spread) have preceded most U.S. recessions. Thus, the yield curve is considered an important barometer for predicting business cycle turning points. See the chart at the bottom of Page 3 for inversions and subsequent recessions that occurred over the last 20 years.

You will remember a lot of media discussion in the last week of March about the inversion that occurred when the 10-year rate briefly fell below the 3-month rate. That is all forgotten now as the rates quickly reverted to the "norm". What was not mentioned was that the 5-year rate fell below the 2-year rate at the beginning of March, and they both declined below the 3-month rate at about the same time. The 5-year and the 2-year continue to trend below the 3-month, but the 5/2 yield rates are now identical and have been for the last three days. That inversion has ended, at least for now.

We put most credence on the 10-year/2-year ratio in terms of achieving an inversion and then assessing the likelihood of a subsequent recession. But, with there being so many other rate comparison possibilities, we prefer multiple inversion scenarios occur before sounding the recessionary alarm.

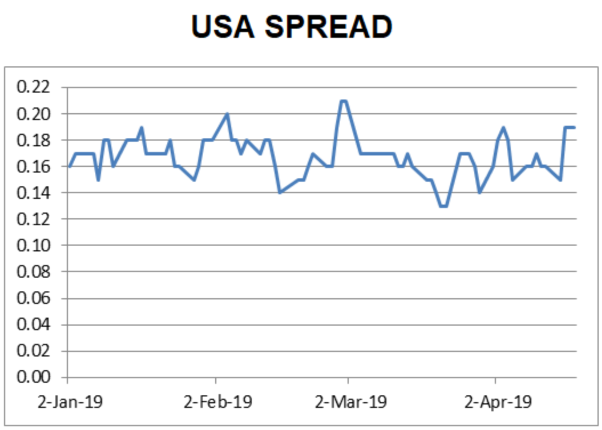
At the moment, with the spread rising, there is no clear and present danger of an inversion occurring in the major 10/2 metric and, therefore, there is no U.S. recession looming on the horizon.

Also, just because an inversion occurs, it is not automatic that a recession follows. When one does occur, the average lag time is 15 to 20 months. If an inversion occurs for just one day, is it automatic that the recession count-down begins at that point? Or, should there be a certain number of days of a continuous inversion to give confirmation? In our opinion, at least a week would be a minimum, and a two-week period would be satisfactory.

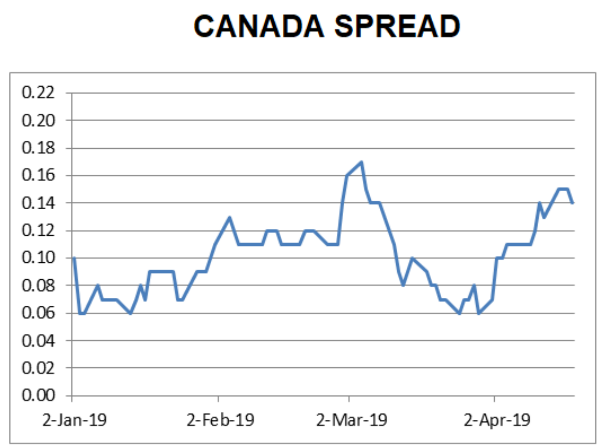
THE SPREAD

The charts provided below show the “spread” between the yields on 10-year versus 2-year Treasuries/Canadas. Since the beginning of 2019, the U.S. Spread has ranged between 0.21x and 0.13x. The range for the Canadian Spread is 0.17x and 0.06x. The respective Spreads right now are 0.19x and 0.14x. In both instances, there is no discernible move towards 0.00x, an inversion, and a possible subsequent recession.

January 2, 2019 – April 18, 2019



January 2, 2019 – April 18, 2019



YIELD RATES

The next two charts show the actual rates for 10-year and 2-year Treasuries/Canadas since the beginning of the year. Rates bottomed in the last week of March and then rebounded, taking pressure off of recession fears. With its significantly stronger overall economy, U.S. rates are well above corresponding Canadian rates. This should continue.

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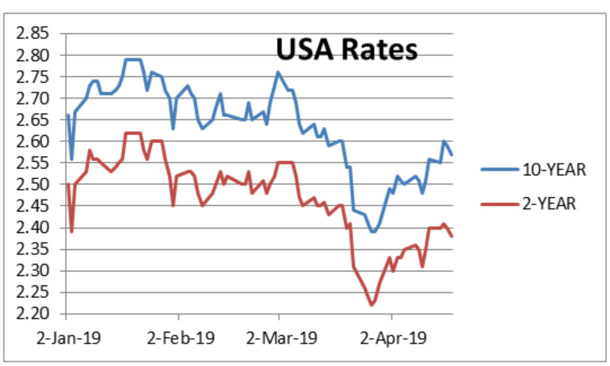

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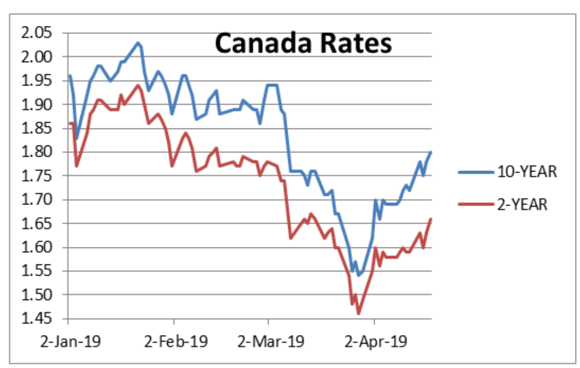

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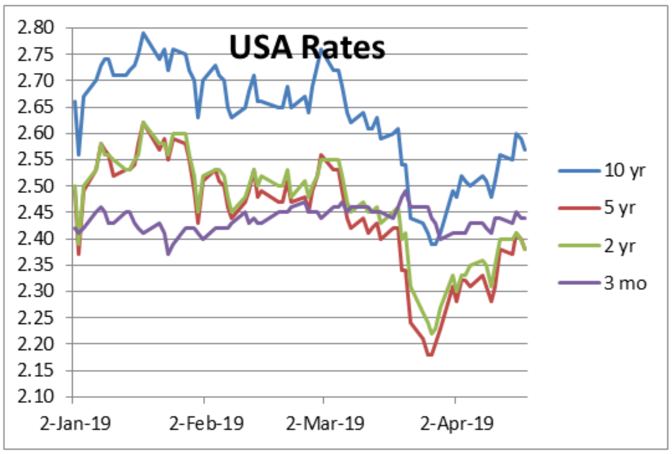
VARIOUS YIELD RATES

The next chart shows the trend in rates since the beginning of 2019 for 10-year, 5-year, 2-year, and 3-month Treasuries. Since the beginning of March, the 5-year was yielding less than the 2-year, a distinct inversion. However, for the last three days, the two yields are exactly the same for both durations. In addition, for a brief period in the last week of March, the 10-year was yielding less than the 3-month. This has since reverted to the "norm".

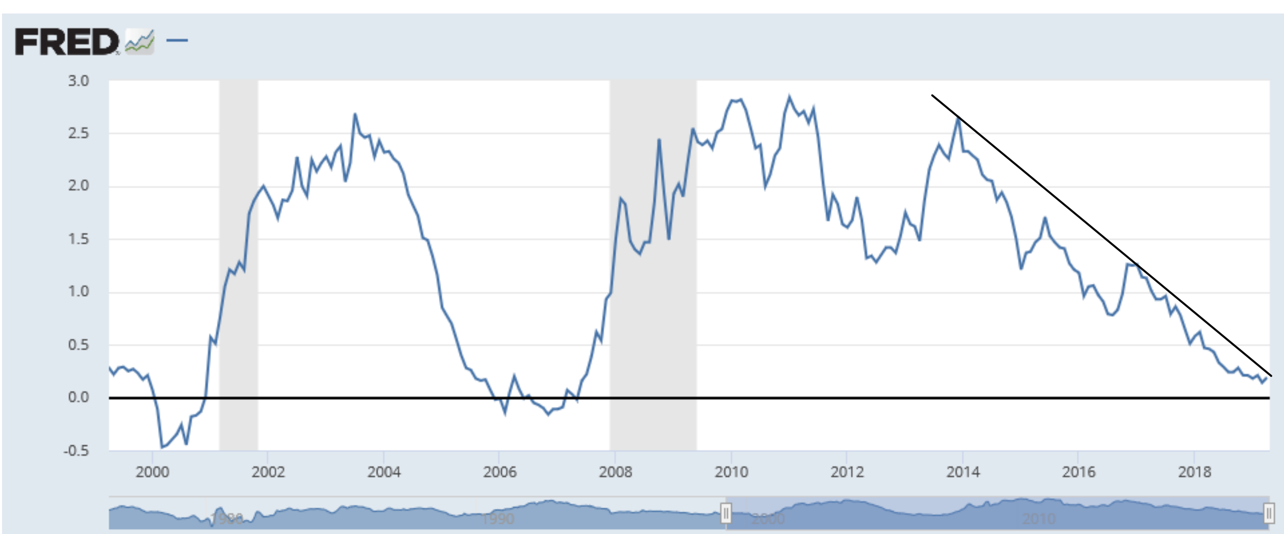
January 2, 2019 – April 18, 2019



U.S. Treasuries 10-2 Yield Ratio Since April 1, 1999 (20 Years)

Here is a look at the 10-2 yield curve going back 20 years to April 1999. It shows the negative occurrences (below 0.0x) and the corresponding recessions (shaded areas) that soon followed. There was a false occurrence in 2006, but which became a distinct reality in 2007.

Currently, despite the falling trend-line that began at the beginning of 2014, there is still further to go to reach the inversion level and the possibility of a resulting recession. In fact, the current ratio is 0.19x, and is at the high end of its recent range. Also, the yield spread looks to have bottomed, at least temporarily, and could continue moving up to attempt a test of the downward trend-line.



U.S. Treasuries 10-2 Yield Ratio Since April 1, 2013 (6 Years)

The following chart provides a clearer assessment of just how close the 10-2 spread is to testing the down-trend line.

The short horizontal **red** line indicates that a successful break-out above the down-trend line would occur around 0.28x, a level that was last achieved in mid-October 2018 when the ratio was in a declining mode. The current ratio, at 0.19x, is still a long way from getting to that break-out level.

Recession Forecast

The following chart shows when a recession could occur for various post-inversion dates. For inversion, we are using the 10-year/2-year metric. Our current "guess" is 15 months post-inversion (shown in Red). This is a "moving target" and will change with each ensuing month. It will also change with changes in global economic conditions.

Right now, the global economy is showing some signs of slowing while the U.S. economy keeps "chuggin' along". Longer term, this is not sustainable.

Forecasting the Commencement of a Recession

If an inversion occurs during the current month …	… then a recession will begin at stated date projections.					
Current Month	**Inversion +12 Months**	**Inversion +15 Months**	**Inversion +18 Months**	**Inversion +24 Months**	**Inversion +30 Months**	**Inversion +36 Months**
April/2019	April/2020	**July/2020**	Oct/2020	April/2021	Oct/2021	March/2022

Source: eResearch

Bob Weir, CFA: Contributing Analyst

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