# RECESSION BAROMETER

## *May 10, 2019*

## *Spotlight on* : 10-2 Yield Curve

**COMMENT**: *Rates moved lower this past week in both Canada and the USA. However, the Spread moved decidedly lower in Canada, dropping from 0.14x to 0.10x, while in the USA, the Spread ended the week unchanged, at 0.21x. As we show on the two 10-year/2-year Spread charts for the last six years and the past 3 years, the Spread is nowhere near challenging the Inversion level. In fact, the U.S. Spread is close to testing its intermediate down-trend line. Both charts are presented on Page 5.*

*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. For the last two weeks, our Recession Barometer Reading has been 6.5x, where 0.0x is a level that is the least worrisome, and 10.0x represents an Inversion and the likelihood of a subsequent recession.*

*There was 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. 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 that multiple inversion scenarios occur before sounding the recessionary alarm.*

*At the moment, with the U.S. spread being stable at a relatively lofty level, there is no concern of an inversion occurring in the major 10/2 metric and, therefore, there is no U.S. recession looming on the horizon.*

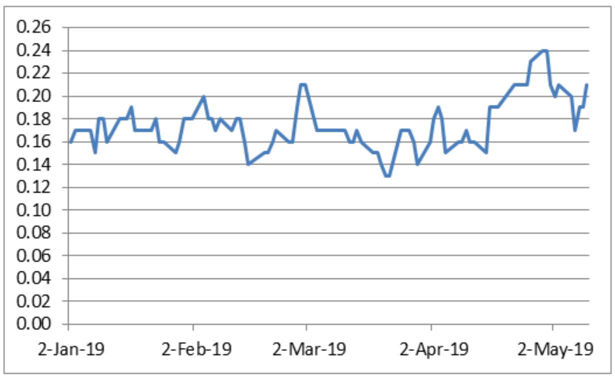
*Also, just because an inversion occurs, it is not automatic that a recession follows. When one does occur, the average lag time is 15 to 20 months. If an inversion occurs for just one day, is it automatic that the recession count-down begins at that point? Or, should there be a certain number of days 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 0.24x and 0.13x. The range for the Canadian Spread is 0.18x and 0.06x. The respective Spreads right now are 0.21x and 0.10x. Last week, it was 0.21x and 0.14x respectively. So, the Spread in Canada narrowed appreciably last week. Still, in both countries, there is no discernible move towards 0.00x, which demarks an inversion, and a possible subsequent recession.

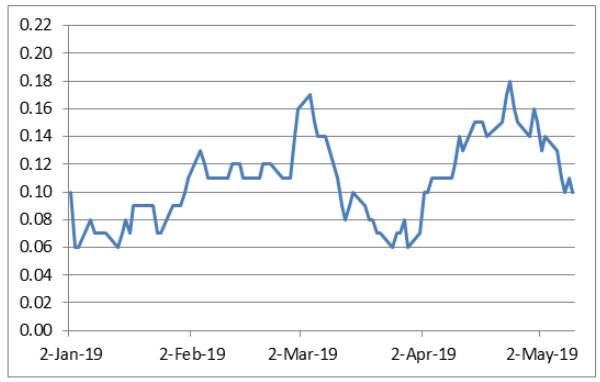
**January 2, 2019 – May 10, 2019**

**USA SPREAD**




**January 2, 2019 – May 10, 2019**

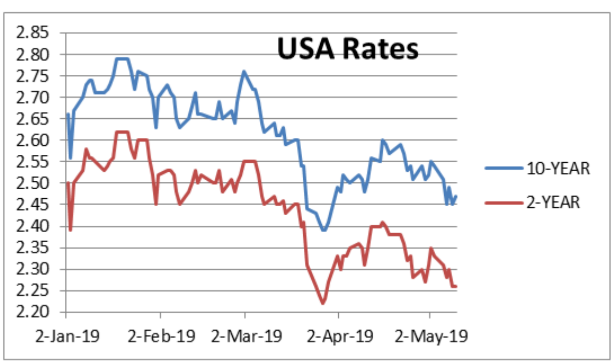
**CANADA SPREAD**



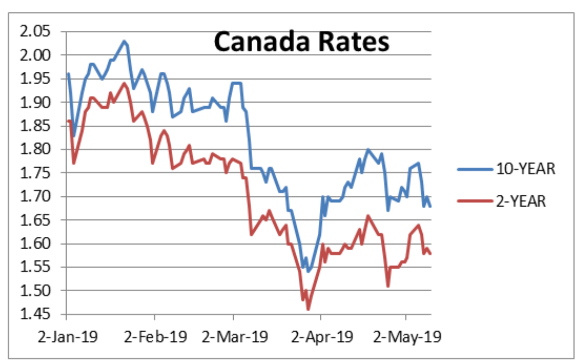

# YIELD RATES

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. This past week, both 10-year and 2-year rates fell significantly in both countries, but still nowhere near the aforementioned lows of late March. Canadian rates continue to trend well below the corresponding U.S. rates. This should continue.

**January 2, 2019 – May 10, 2019**




**January 2, 2019 – May 10, 2019**

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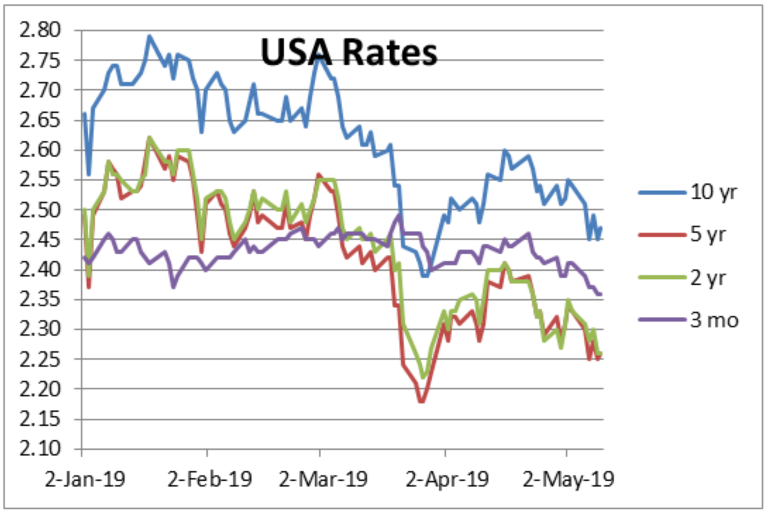
# VARIOUS YIELD RATES

The next chart shows the trend in rates since the beginning of 2019 for 10-year, 5-year, 2-year, and 3-month Treasuries. For a brief period in the last week of March, the 10-year (**blue** line) was yielding less than the 3-month (**purple** line). This has since reverted to the "norm".

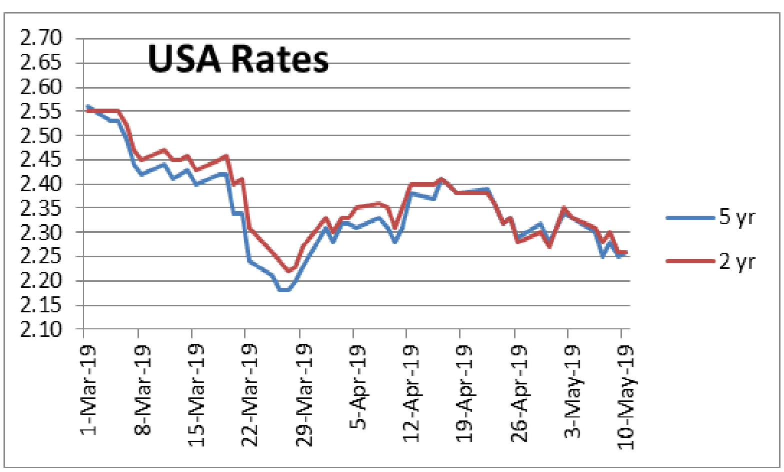
**January 2, 2019 – May 10, 2019**




Since the beginning of March, the 5-year (**red**) was yielding less than the 2-year (**green**), a distinct inversion.

However, since April 16, the two yields have been exactly the same, or just one or two basis points apart, for both durations. In the following chart, the 5-year is shown in **blue** and the 2-year in **red**.

**March 1, 2019 – May 10, 2019**

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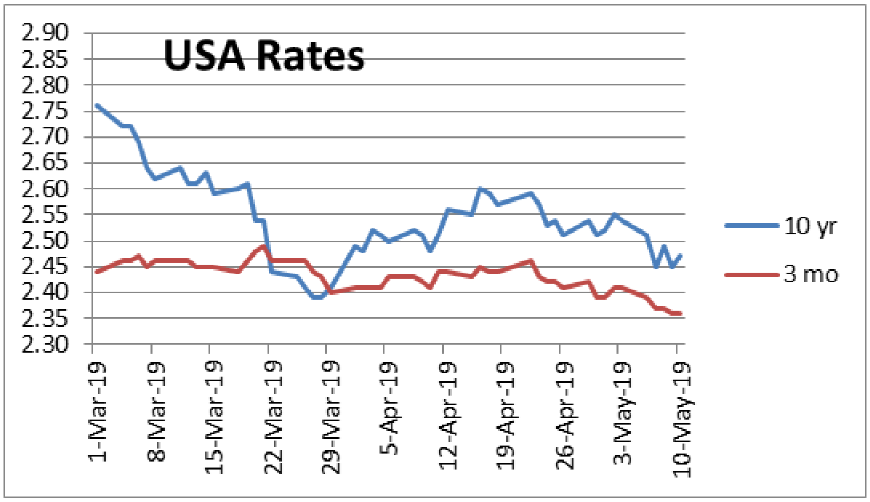
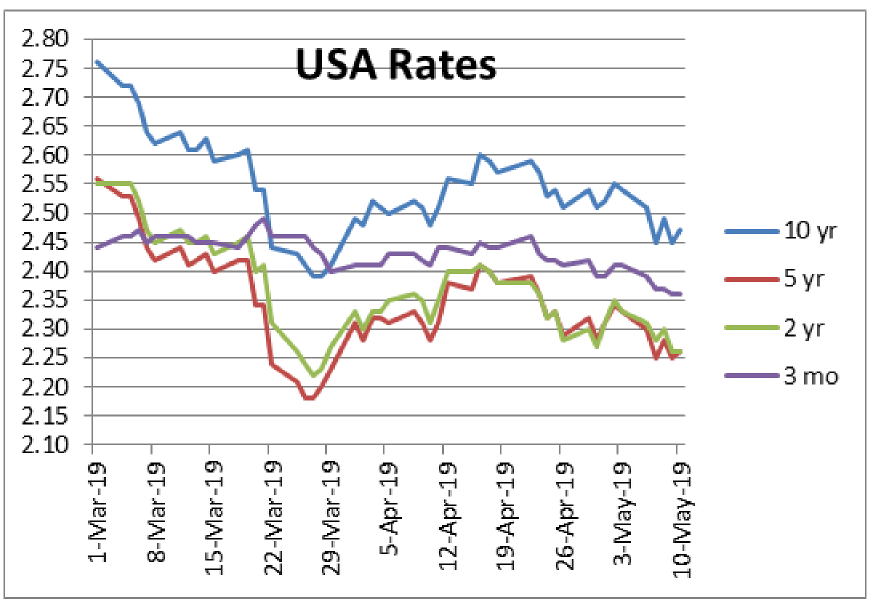
In the last week of March, for a brief time, the yield on 10-year Treasuries fell below the yield on 3-month Treasuries. This aberration ended quickly, although it is fair to say that the difference between the two rates should certainly be more than what it is, even now. See the chart below.

**March 1, 2019 – May 10, 2019**




Normally, the 3-month yield would be below the 5-year and 2-year, but that is not the case. Here, again, to reinforce our point, is the 4-duration yield chart presented on the previous page. Anomaly!

**March 1, 2019 – May 10, 2019**

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

The following chart shows the latest prolonged down-trend in the 10-year/2-year yield spread. If the spread moves higher, or if it just stays constant, it will soon move to test the down-trend line, the first such challenge since February 9, 2018. However, there is still quite a ways to go before it breaks through the down-trend line.


How about a shorter-term chart? What does it say?

## U.S. Treasuries 10-2 Yield Ratio Since May 10, 2016 (3 Years)


The same down-trend line is drawn. After almost touching the down-trend line on April 29, 2019, the spread has moved slightly lower. However, it could be readying itself to take another run at breaching the declining spread line.

**<continued>**

# 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 performing well. But how much better can the U.S. figures get? 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** |
| May/2019 | May/2020 | **August/2020** | Nov/2020 | May/2021 | Nov/2021 | April/2022 |

Source: eResearch

See the Recession Barometer Reading on the following page.

# RECESSION BAROMETER READING

We have devised a barometer to depict the status of where we believe the economy is in forecasting an economic recession. The barometer runs from 0 to 10, with 0 being the least worrisome level for recession expectations, and 10 reflecting that an inversion has occurred. Each barometer numeric is associated with a range of yield spreads.

Currently, for 10-year/2-year Treasuries/Canadas, the Canadian barometer reads “7”, while the U.S. barometer reads “6”. This better U.S. reading reflects the stronger economy currently in place in the USA than in Canada.

We extended the concept to the 10-year/3-month and the 5-year/2-year yield spreads, for which we have only U.S. readings. The current 10-year/3-month reading is “7”, and the 5-year/2-year reading is “9”. We then weighted the three yield spreads, being 70% for the 10Y/2Y, 20% for the 10Y/3M, and 10% for the 5Y/2Y. The weighted barometer reading was “6.5”.

**RECESSION BAROMETER**

| Interest Rate Yield Spread | Barometer Reading | |
|---|---|---|
| >1.00x | 0 | |
| 0.85x - 1.00x | 1 | |
| 0.70x - 0.84x | 2 | |
| 0.55x - 0.69x | 3 | |
| 0.40x - 0.54x | 4 | |
| 0.30x - 0.39x | 5 | |
| 0.20x - 0.29x | 6 | |
| 0.10x - 0.19x | 7 | |
| 0.05x - 0.09x | 8 | |
| 0.00x - 0.04x | 9 | |
| <0.00x | 10 | Inversion! |

Source: *e*Research

Weighted U.S. Reading (0.7/0.2/0.1)
6.5

**10-Year/2-Year**

CURRENT READING

| | | |
|---|---|---|
| USA = | 0.21 x | 6 |
| Canada = | 0.10 x | 7 |

**10-Year/3-Month**

CURRENT READING

| | | |
|---|---|---|
| USA = | 0.11 x | 7 |

**5-Year/2-Year**

CURRENT READING

| | | |
|---|---|---|
| USA = | 0.00 x | 9 |

| Date | Reading |
|---|---|
| May 3, 2019 | 6.5x |
| May 10, 2019 | 6.5x |

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