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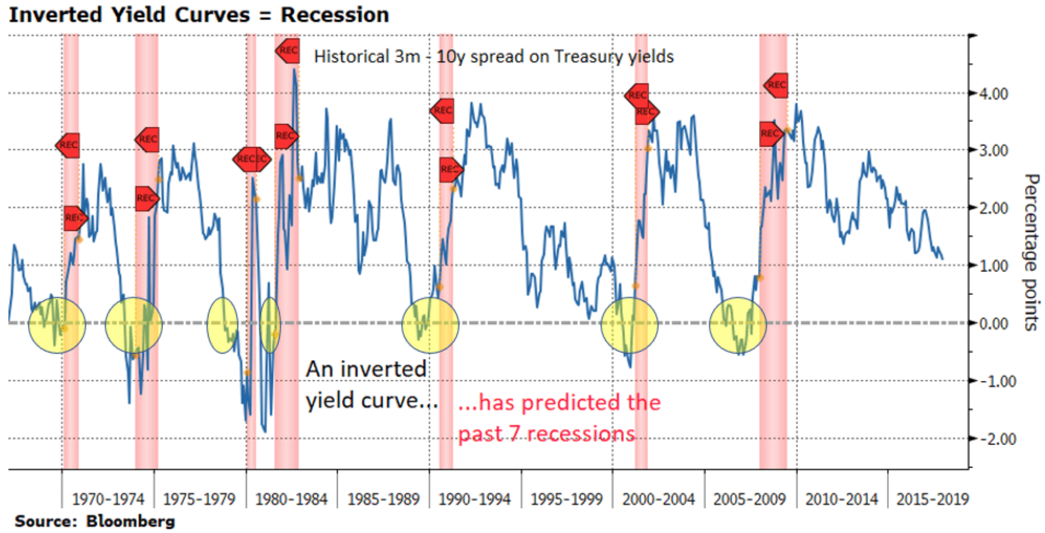
Inverted Yield Curve

April 2019

In March 2019, the yield on the benchmark 10-year Treasury note fell to 2.42% percent, dropping below three-months treasury bills for the first time since July 2007. "Investors' willingness to accept a lower yield on a longer, and thus riskier, fixed-income instrument classically has been a harbinger of an economic downturn"[i], and the fear of recession once again created market volatility.



What caused the inversion? U.S. Treasuries remain the safe haven for foreign investments, especially in an environment where Japan and German bonds are trading below 0%. Large inflows of capital along with recent increases in the Federal Funds Rate caused this temporary inversion.

How does this compare to past recessions? The Federal Funds Rate in prior recessions (post 1960) was +2% above core inflation, compared to +0.3% today. "Money is relatively cheaper today than before prior corrections"[ii]. This is a concept called "bull inversion", when prices are in check, and there is no need to artificially pump on the break.

Separately, while the U.S treasury yield curve may be inverted, the short and long-term corporate bond spread remains healthy at 120 basis points, compared to an average of 80 basis points since 2000. "That spread difference last inverted in March 2008, about five months before the financial crisis".

Will there be a recession? It is our view that a recession is not imminent, as measured by corporate bonds and equity investor confidence. However, the inverted treasury yield curve does call for our attention to monitor risk, particularly in other parts of the world, and their impact on the U.S. economy.

Source: i/www.barrons.com, ii/fa-magazine, iii/finance.yahoo.com/

[i] https://www.barrons.com/articles/is-there-a-recession-on-the-way-corporate-bonds-say-no-51553696511
[ii] https://www.fa-mag.com/news/the-inverted-yield-curve-deserves-better-scrutiny-44212.html