Thursday, March 28, 2019

Good Afternoon,

While stocks normally capture the headlines in the investment world, it's the bond market that's grabbed the spotlight of late. Are bonds trying to tell us something? Are they flashing a yellow light? Remember when we talk about bonds, we essentially refer to interest rates and the dividend yields paid on US Treasury obligations.

To review, the Fed made a surprisingly dovish (think lower rates) statement after its latest meeting, where it essentially put rate interest increases on hold for the year and noted it would be stopping the drawdown of their balance sheet this year. As a result, markets dropped their expectations for rates—and rates subsequently declined for longer-dated maturities. This decline left the interest rate on 3-month Treasury note above that on 10-year Treasury bond, which is the definition of a "yield curve inversion."

If you think about it, the fact that you can borrow cheaper for 10 years than for 3 months is a signal that something is wrong. As such, the yield curve inversion makes sense as a risk indicator. Historically, yield inversions are fairly accurate in predicting pending economic recessions. However, the lead time could be anywhere from 6 to 18 months out. The fact that we haven't seen a recession in over ten years indicates we are due for one at some point. Also, economic growth has been rather slow since 2009 so we wouldn't need a sharp contraction to drift into recession territory. In other words, it doesn't mean the economy would tank; it may just shrink a bit.

Are we facing the end of the ten-year growth cycle? Perhaps, but benign inflation, an accommodative Fed, and reasonable equity valuations should all serve to extend this cycle further, not end it now. Time will tell.

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http://www.commonwealth.com/RepSiteContent/weekly_comm/commentary_redirect.htm

As always, if you would like to discuss this or anything regarding current market conditions or your portfolio, feel free to contact me at any time.

Enjoy your weekend,

Wade

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