Yield Curve Inversion, Trade Dispute and Weak Economies World Wide: Are We Headed for a Recession?

Markets continue to be extremely volatile as we head into the second half of the month. This is true of both equities and bonds. Prices are moving up and down more than one percent on a daily basis. Defensive equities like consumer staples, utilities and healthcare have outperformed growth and cyclical stocks since the end of July. We continue to see weak manufacturing data come in here in the U.S. These numbers, coupled with central bankers around the world lowering rates, have the bond market pricing in a nearly 40 percent chance of a 50-basis point interest rate cut at our Federal Reserve Board Meeting in October.

Television analysts are pointing out that the 2-year and 10-year yield on Treasury bonds briefly inverted last week. This condition has preceded many past recessions and is worth watching as it suggests weak demand-side growth going forward. We are late in the bull cycle anyway, and the ongoing trade war with China may be enough to finally tip us over. Europe, Latin America, China, and the rest of the world are mired in stagnate or weakening growth. Poor prospects elsewhere cause investors to buy our longer-term bonds, which compounds our “yield curve problem” by pushing down the yield on longer-term bonds. I read yesterday that Denmark’s negative interest rates are resulting in banks actually paying borrowers to take out mortgages. Yes, you read that right. Customers are getting paid by the banks to take out a loan. Doesn’t that mean it’s not really a loan at all? There are a lot of other countries in similar situations right now. You don’t have to be a genius to understand that the global economy is simply not set up to work that way. How this ultimately plays out across the world is anyone’s guess, but I am certainly interested to find out.

President Trump and his economic advisors were out in full force over the weekend, downplaying the importance of these issues as well as the long-term impact from the trade dispute. President Trump’s re-election hopes can’t afford a recession and stock market plunge. One would suspect that they are paddling hard beneath the surface to get some help from the Federal Reserve and a solution to the China problem.

Last week’s market commentary can be found here.


G. Chadd Mason
CEO, The Cabana Group

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