DELTA INVESTMENT MANAGEMENT

Delta Insights
a weekly commentary on investing

March 29, 2019

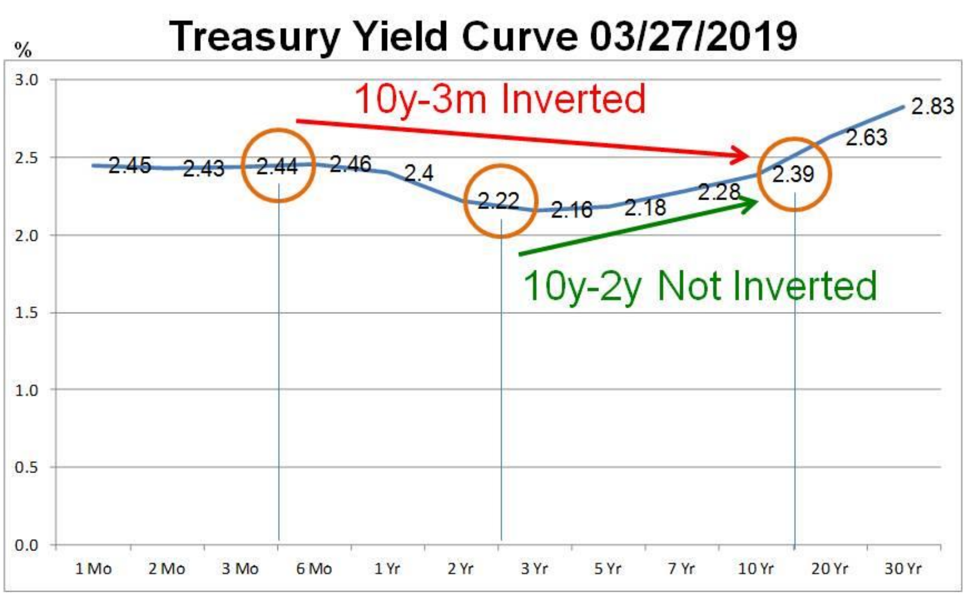
Recession?

Since 1965, the U.S. treasury yield curve has inverted seven times. By this, we mean the 10-year treasury rate has been lower than the 2-year treasury rate. Recession followed on average about 14 months later. During recessions in 1973-74, 2000-02 and 2007-09, the S&P 500 lost roughly half of its value. Yield curve inversion, recessions and the stock market losing half of its value are important concerns for stock investors.

The 10-year and 2-year treasury rates (10y-2y) have not inverted. As of March 27, the 2-year treasury rate is 2.22% and the 10-year rate is greater at 2.39%. The spread of 17 basis points is not inconsequential. The 10y-2y is the metric Delta tracks.

The 10-year and 3-month treasury rates (10y-3m) have inverted. As of March 27, the 3-month treasury rate is 2.44% and the 10-year is lower at 2.39%.

The Federal Reserve believes both the 10y-3m and 10y-2y term spreads are predictive indicators of recessions. After examining data from 1972 to 2018, the Fed concludes "all of these term spreads are fairly accurate predictors and quite informative about future recession risk; the differences in forecasting accuracy are small." (Source: FRBSF Economic Letter 2018-20, August 27, 2018)



The U.S. treasury yield curve is giving us a mixed message; both term spreads (10y-2y and 10y-3m) have roughly equal predictive power yet they are not in agreement.

Just like a referee, we can only call what we see. No foul (inversion) has been committed in the 10y-2y spread. The 10y-3m spread may suggest that the entire yield curve will eventually invert sometime in the future but as of this date, it has not. As an impartial judge, we should let play continue until a foul is actually committed.

We have the benefit of time. The fastest elapsed time from inversion to recession was 7 months in March of 1973. Rather than a recession prediction, we may just have a distortion in the short-end of the yield curve.

The short end of the treasury curve has been pushed higher by the Fed's 2018 rate hikes while the longer-dated interest rates have remained low and fallen on a slower economic growth outlook. The growth outlook diminished with corporate earnings estimates being reduced (negative year-over-year earnings growth estimated for the first quarter) and manufacturing activity in some large economies including China and Germany moving into contraction. Since November of 2018, the 10-year treasury rate has declined from about 3.23% to 2.37%. The very short-term rates (particularly the Fed Funds rate) are determined by the Federal Reserve and are unlikely to go down unless the Fed lowers them.

The U.S. and China are engaged in active trade talks which extend into next week. The outcome of these talks may impact global economic growth projections. Two weeks from now, earnings season begins again. Company managements will provide their view on growth. Stronger growth projections could cause the 10-year treasury rate to rise. The 10y-3m inversion may flip to a positive slope on an improved growth outlook or the 10y-2y rates may invert on a disappointing outlook. For now, no foul, play on.

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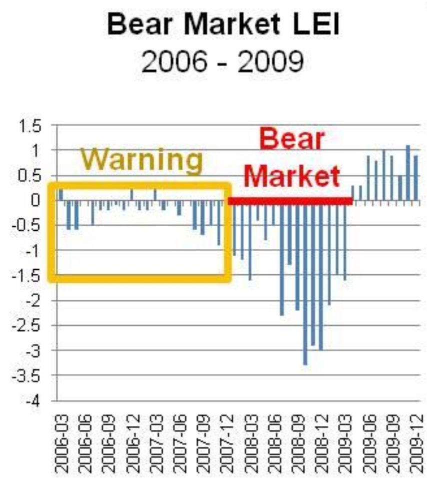
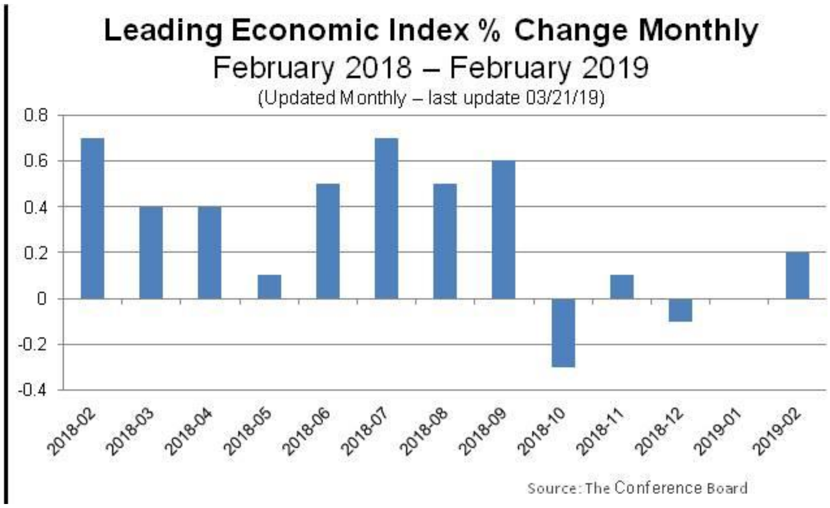
"She's out stimulating the economy – can I take a message?"

Delta Stock Market Dashboard





MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

67.7

Our technical indicator decreased this week from 73.8 to 67.7

INDICATOR STATISTICS

Consecutive Bullish Weeks:	9
Cycle Inception Date:	1/31/2019
Range:	59.5 – 77.7
Mean:	71.6
Bullish Weeks YTD:	9
Bearish Weeks YTD:	4
*S&P 500	3.9%
*DJIA	2.7%
*NASDAQ	5.2%

** Percentage change during current cycle*

(Delta MSI is published every week in ***Barron's***)

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