CBL WEALTH MANAGEMENT
REGISTERED INVESTMENT ADVISOR LIC. # 289564

Market Brief

August 14, 2019

Market Snapshot

Closing Values as of 08/14/2019

Dow	25,479
S&P 500	2,841
Nasdaq	7,774
Gold	$1,529

Earlier today (8/14/19) the bond market flashed a signal has almost always preceded an economic recession by 14-22 months, the 10 year treasury rate dipped below the 2 year treasury rate. The markets consider this type of inversion both a symptom of conditions that lead to recession and a predictive signal that a recession is on the horizon.

It would be wrong to imply that the 2 year/10 year inversion that occurred today is meaningless but I wouldn't rush to call it a clear signal of recession either. I believe global economic and credit conditions may warrant a second look at the brief, hours long, 2yr/10yr inversion before allowing it to be called the signal that a U.S. recession is on the horizon. In other words, it may be a false recession signal. I strongly believe the recent inversions are more a symptom of current global economic and credit issues than a cause for future U.S. recession.

For the yield curve inversion to be a signal of pending recession the changes in yield would need to be driven primarily by market expectations of slowing U.S. economic conditions leading to lower rates. I am not sure that's the case here. There has been some concern that trade issues might be slowing our economy but there hasn't been a moment of increased slowing that has led to a sudden inversion. I think the majority of movement in the yield curve has been caused by external global factors, chief among them being the massive amount of international government debt trading at NEGATIVE rates and the slowing global economies. U.S. Treasuries offer both return and safe haven for global investors overcome by fear with no place else to put their money.

As fear and uncertainty increase the demand for U.S. Treasuries of all denominations, prices rise and yields fall. Former Fed Chair Alan Greenspan pointed out in an interview with Bloomberg that international arbitrage has driven U.S. treasury rates lower and could, in theory, result in zero or negative rate U.S. treasuries since there is no barrier to such an occurrence. I believe the Federal Reserve will take swift action when and as needed to prop up the U.S. economy and stabilize the yield curve. In addition to lowering rates at or before the next meeting I believe the Fed will be considering more aggressive moves to steepen the longer end of the yield curve. Such moves might include aggressive selling of 10 year treasuries from their balance sheet with matched buying of short term treasuries, the opposite of "operation twist" executed by Bernanke. The result would be a flood of supply in 10 year treasuries, driving prices down and rates up while simultaneously keeping supply of shorter dated treasuries tight, prices high and rates low…resulting in a steepening of the yield curve. This seems drastic and possibly uncalled for but given the state of the global economy it may the kind of manipulation that needs to be done, whether by the U.S. Federal reserve or another central bank.

As of the writing of this brief the overnight market futures appear stable, an indication the markets are likely to take a well-deserved breather after selling off so aggressively today. At the time of writing the markets have pulled back between 5 and 6 percent from the highs seen several weeks ago. Despite the volatility we have seen over the last two weeks, the market appears quite resilient. I don't discount the idea that the markets might continue to move lower, possibly into correction territory, before ultimately recovering, but, I do believe we will see a recovery in the weeks ahead.

There will be much said about the recent yield curve inversion and how it is a signal of recession. It is true that the 2/10yr inversion has been a very reliable indicator but it is also true that a few hours of inversion is NOT a signal. In every case prior to now the inversion has lasted many weeks or months, and always more than a few hours or days. It is also true that the inversion has historically occurred an average of 14-22months prior to the onset of recession AND the 12 months following the inversion signal have seen double digit stock market gains. If not today, the 2 year and 10 year treasury inversion will be signal a recessing on the horizon. When that time comes it is important to remember it is not a time to panic but a time to prepare.

Nothing about the volatility over the last two weeks to the inversion of the 2 year/10 year treasuries today concerns me enough to suggest deviating significantly from your target allocation. It may be appropriate to hold additional cash for short term needs or to build your cash position by selling into gains if you anticipate needing additional income in the next 12-18 months.