Brinker Capital

WEEKLY WIRE | JUNE 24, 2019

A tale of two yield curves

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to heaven, we were all going direct the other way - in short, the period was so far like the present period, that some of its noisiest authorities insisted on its being received, for good or for evil, in the superlative degree of comparison only."

- *A Tale of Two Cities*, Charles Dickens

While Charles Dickens had revolutionary-era France in mind when penning his literary classic, *A Tale Of Two Cities*, his prose could easily apply to the US yield curve and what it might – or might not – be telling us about our economy today.

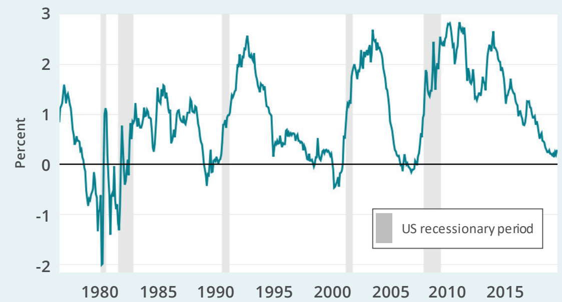
The yield curve is a plotting of yields associated with US Government debt (bills, notes and bonds). Usually, debt of a shorter maturity offers a yield lower than debt of a longer maturity since the risks associated with loaning money to our government increase as maturity lengthens. When shorter maturity debt offers lower yields than longer maturity debt, the yield curve is said to be positively sloped.

When shorter maturity debt offers a yield equal to longer maturity debt, it is said to be flat. And when shorter maturity debt offers a greater yield than longer maturity debt, the curve is said to be inverted. Wall Street pays attention to the shape as an inverted curve has historically preceded an economic downturn. This brings us back to our friend, Mr. Dickens.

Parts of the curve have inverted, particularly the US 3-month/10-year section, leading many to conclude a recession is imminent. However, the US 2-year/10-year section – historically the most influential part – has not only not inverted, it has become more positively sloped (albeit off a very low, near flat level), leading many to conclude the US economy, while maybe slowing, is not at risk of a recession (see above right). Given these contrasting signals, what is an investor to think?

Brinker Capital believes the slight inversion of the US 3-month/10-year curve isn't a signal of pending recession, but instead a signal that credit conditions are too tight and that the US Federal Reserve should loosen monetary policy in the back half of 2019. We also believe that if we can solve for US/China trade and the Fed does become more accommodative – and we expect both will come to pass – the US economy will continue to expand into 2020.

10-Year Treasury Constant Maturity Minus 2-Year Treasury Maturity



Equities, oil & natural gas (6/21/19)

Security name	Last	QTD chg	YTD chg	12mo chg
S&P 500	2950.46	4.09%	17.70%	7.10%
Russell 2000	1549.63	0.64%	14.91%	-8.07%
Russell 3000 Growth	1289.69	4.80%	21.36%	7.89%
Russell 3000 Value	1643.68	2.68%	14.19%	3.05%
Crude Oil WTI (NYM $/bbl)	57.60	-4.22%	26.84%	-16.01%
Natural Gas	2.18	-17.99%	-23.43%	-25.87%

Treasury rates (6/21/19)

	Price	Yield
2Y	100.220 / 100.2	1.758
3Y	100.026 / 100.0	1.715
5Y	101.004 / 101.0	1.782
7Y	101.106 / 101.1	1.917
10Y	102.262 / 102.2	2.058
30Y	106.000 / 106.0	2.585

Weekly reports

This week
- Chicago PMI
- Michigan Consumer Sentiment

Last week
- Philadelphia Fed IDX 0.3
- Markit PMI Manufacturing 50.1

Brinker Capital Market Barometer

JUNE 2019

The weight of the evidence still leans positive which is in line with our slight overweight to risk in moderate to aggressive portfolios.

SHORT-TERM FACTORS (< 6 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Momentum	←		●		Market momentum weakened
Trend	←←	●			Global equity indices generally below ST and LT moving averages
Investor sentiment	→		●		Investors more pessimistic but not yet reached capitulation
Seasonality				●	Seasonality more supportive in second quarter

INTERMEDIATE-TERM FACTORS (6-36 months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Fiscal policy				●	Fiscal stimulus continues in 2019
Monetary policy				●	Fed on an extended pause and will end balance sheet reduction
Inflation			●		Fed sees inflation as running below target
Interest rate environment			●		Longer-term rates range-bound; yield curve inversion at short end
Macroeconomic	←		●		US growth solid but ex-US growth weaker; global trade war concerns
Business sentiment			●		Small biz confidence off record high; CEO confidence little improved
Consumer sentiment				●	Remain at elevated levels; still supportive
Corporate earnings				●	US earnings growth still solid; softer outside US
Credit environment				●	Slight widening of corporate credit spreads but few signs of stress

LONG-TERM FACTORS (36+ months)

	CHANGE	NEGATIVE	NEUTRAL	POSITIVE	
Valuation			●		US equity valuations at long-term averages; more attractive ex-US
Business cycle				●	Long recovery but has been muted; few signs point to recession
Demographics			●		Mixed (US and emerging markets positive; developed int'l negative)