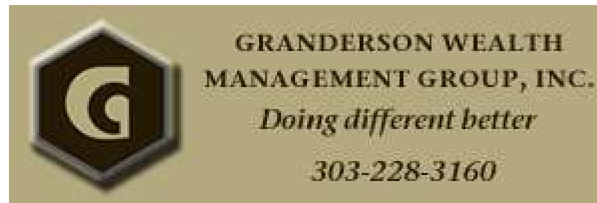

Don’t panic over this freak of economic nature

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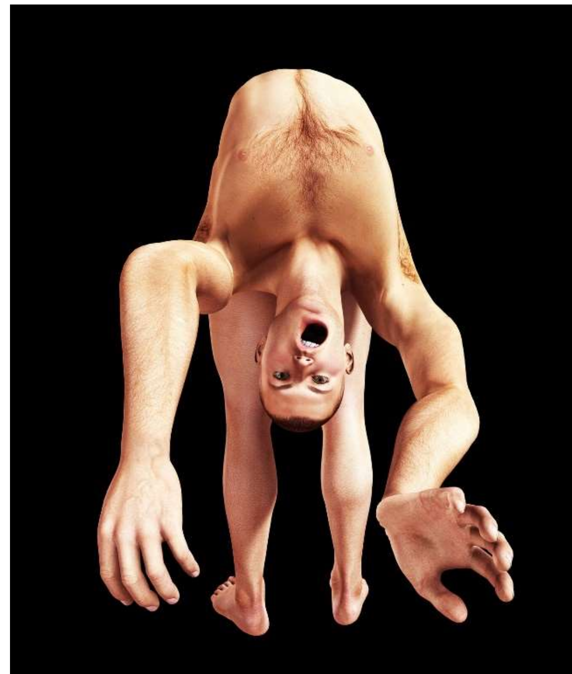

We have heard in recent weeks about a condition in the securities market called an “inverted yield curve,” and to the uninformed investor, this complex terminology might sound like the newest position in yoga training.

Nope, it is nothing quite so painful! Instead, the IYC appears when the interest rates on long-term bonds illogically fall BELOW the interest rates of short-term bonds. We call it illogical, because it seems to make sense that investors would be rewarded for their patience on those long-term bonds. In the IYC climate, they are NOT.

Some economists begin to panic when “up” literally becomes “down” in their world, and they point to other IYCs that preceded recessions. True, we could end up in a recession in coming months; but at GRAnderson Wealth Management Group, we don’t believe there is a direct correlation. In a recent article, the Wall Street Journal said there is some disagreement whether this IYC condition has a “mechanical effect on the economy – by reducing the willingness of banks to lend, for example – or whether yields merely reflect changes in sentiment.” We opt for the latter.

We see multiple factors contributing to the inverted yield curve. Here are just a few:

Corporate earnings are perhaps not as strong as they had been; and so investors switch to long-term securities. That increase in demand for long-term securities tends to boost their prices, which in term tends to lower their yields. It’s just the way bonds work. **This three-step process (increase in demand,**

boost in prices, decrease in yields) applies to other factors here; and it works in reverse for short-term securities.

The long-term economic projections are bright! Therefore, people become more attracted to long-term bonds (and the above three-step process kicks in).

Lower interest rates in other countries drive those foreign investors into the U.S. market (and the three-step process applies).

We entered into an IYC in August, and prior to that we experienced one in March. After that March IYC, the U.S. economy experienced a 2.1% annualized growth rate. You could argue (and many experts do!) that there is considerable lag time between the IYC and the subsequent recession. And we could understand a full quarter or even a half-year of lag time. But any longer than that seems unreasonable to us, and if a recession arrives 9 months or a year after the advent of an IYC, we think that's probably just happenstance.

Recessions are inevitable. If a recession occurs after an IYC, we don't think it's proof of anything. It's like saying the stock market goes up an old NFL team wins the Super Bowl. Well, sure, but the stock market USUALLY goes up. So we don't believe in that "indicator" either.

And here is the most important component to consider. Even if the IYC results in a recession, it won't have much impact on long-term investors, who are positioned to weather a typical recession. And that's our mantra at GRAnderson Wealth – invest for the long term.

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