LET’S GET TECHNICAL PART 3:
YIELD CURVES
Let’s Get Technical Part 3: Yield Curves

Dear Subscriber,

We introduced the Critical Signals Report Storm Tracker here as our starting point when it comes to assessing global risk and the proximity of the next recession. We also described how we look at market trends in Part 1 and how we measure leading indicators in Part 2 of this series.

Today, in Part 3, we share with you how we use yield curves to track market weather direction.

Let’s Get Started

By definition, the yield curve is a curve that plots a variety of yields (interest rates) across various time frames, generally extending from very short-term periods (as in months) to longer periods (as in years). The curve displays the relationship between interest rates (the cost of borrowing) over an extended arc (or “curve”) of time.
The shape of the yield curve is what matters when it comes to predicting what’s going on and what may be next. Yield curve shape (or slope) can be normal (upward sloping), flat, or inverted (downward sloping)…

Normal yield curves display rising interest rates over time, providing a rising premium (or return) to investors willing to hold, say, U.S. Treasuries long term. Flat yield curves display no premium or incentive to hold Treasuries long term. Inverted Yield curves (yield curves that go from normal to flat and subsequently invert) provide a distinct disincentive to hold Treasury instruments long term.

Yield curves that are normal or upward sloping generally accompany periods of economic expansion. Yield curves that flatten or invert are red flags for oncoming recessions. The last seven recessions in the U.S. have been preceded by inverted yield curves. That’s a pretty darn good scorecard.

Yet the yield curve is not the end-all when it comes to predicting recessions because historically, not all recessions have been preceded by inverted yield curves.

So Where Does That Leave Us?

That leaves us with a very powerful thermometer to gauge whether the economy is healthy, getting a fever, or headed into the ICU. Combined with trends (see Part 1) and leading indicators (see Part 2), the yield curve is invaluable.

Today, global yield curves are emitting a ton of critical signals. They are not neat and tidy but rather are pretty messy, which suggests that global economies are at risk. Let’s take a quick walkabout.

Here’s the U.S. Treasury yield curve as of May 24, 2019. We call this one messy because it is inverted in the short term, then flattens out, and then rises as curves normally do in the long term. Overall though, that big dip in the short term is worrisome. Also, interest rates along the curve are uniformly LOW, so it wouldn’t take too much for this curve to completely flatten or invert.
The Euro Area Yield Curve

The euro area yield curve looks pretty good, right? Most of the curve displays a normal profile. Well… no… this curve is messy too – but for another reason. Out 10 years, this curve is underwater, i.e. negative yielding! In Europe, you literally have to pay the banks to take your money! How healthy is that? Not very.

Japan’s Yield Curve

At first glance, Japan’s yield curve looks pretty normal, but like Europe, the Japanese yield curve is also massively underwater. Yield in absolute terms is miserably low all along the curve. Like Europe, not good.
China’s Yield Curve

Here’s a surprise: China’s yield curve is the best of the bunch. It is mostly normal and upward sloping to the right. True, China has a centrally planned economy and problems with truthful reporting, but hey, it’s working (for now) from a yield-curve perspective.

In fact, China’s yield curve looks a whole lot better than the U.S. yield curve. Does this suggest more staying power than generally believed when it comes to tariff negotiations? We think so.
Adding Them All Up

Yield curves are comparable and relative, so we’ve lined them up for you below.

Is it what you expected? Probably not. China’s on top, with higher interest rates and a better, upward-sloping curve than the U.S., Europe, and Japan. We’d put three out of four of these curves (75%) in the “messy category” because they are either trying to invert (U.S.) or are so low yielding (Europe and Japan) that their economies are hardly functioning.

Interest Rates

Interest rates continuously rise and fall along the length of the yield curve. After the Great Recession, the U.S. government, short-term federal funds rate fell to floor as the Fed and central banks around the world pumped tons of QE into the marketplace.

Historically, before recessions kick in, the federal funds rate rises… until it can rise no further because borrowers, from individuals to corporations, just can’t hack it. At this point, the risk of default looms. So the Fed stops raising rates… rates go flat for a period… and then having gone too high, too fast… the Fed starts lowering them… VERY QUICKLY… to stave off that next recession.
Take a look at the chart below. See those red boxes? These mark the flattening of the federal funds rate just prior to the last two recessions. When the federal funds rate stops rising, recession looms… and that’s where we are today. Add this to your calculus, as we do in Storm Tracker.

Bottom line: Yield curves and interest rates are important. When parts of the yield curves we monitor flatten and start to invert, Storm Tracker is adversely impacted … it rises … along with risk.

**See How This All Fits Together?**

We track global yield curves and interest rates, which inform the *Critical Signals Report* Storm Tracker, which in turn informs the *Critical Signals Report* Crash Portfolio (to be shared soon) of changes that may be required in asset allocation.

But there’s more…

Stay tuned for *Let’s Get Technical Part 4: GDP (Gross Domestic Product)*, coming to your email inbox soon.

**Was This Useful? Do You Have Questions?**

Fire away. We want to hear from you. Please provide your questions/comments below, as we’ll be formulating answers all along this technical journey. In the meantime, be safe out there …
Please Note: From time to time, Money Map Press will recommend stocks or other investments that will not be included in our regular portfolios. There are certain situations where we feel a company may be an extraordinary value but may not necessarily fit within the selection guidelines of these existing portfolios. In these cases, the recommendations are speculative and should not be considered as part of Money Map Press philosophy.

Also, by the time you receive this report, there is a chance that we may have exited a recommendation previously included in our portfolio. Occasionally, this happens because we use a disciplined selling strategy with our investments, meaning that if a company’s share price falls below a certain price level, we immediately notify our subscribers to sell the stock.

NOTE: Money Map Press is not a broker, dealer or licensed investment advisor. No person listed here should be considered as permitted to engage in rendering personalized investment, legal or other professional advice as an agent of Money Map Press. Money Map Press does not receive any compensation for these services. Additionally, any individual services rendered to subscribers by those mentioned are considered completely separate from and outside the scope of services offered by Money Map Press. Therefore if you choose to contact anyone listed here, such contact, as well as any resulting relationship, is strictly between you and them.

All rights reserved. Money Map Press provides its members with unique opportunities to build and protect wealth, globally, under all market conditions. The executive staff, research department and editors who contribute to Money Map Press recommendations are proud of our history and reputation. We believe the advice presented to our subscribers in our published resources and at our meetings and seminars is the best and most useful available to global investors today. The recommendations and analysis presented to members is for the exclusive use of members. Copying or disseminating any information published by Money Map Press, electronic or otherwise, is strictly prohibited. Members should be aware that investment markets have inherent risks and there can be no guarantee of future profits. Likewise, past performance does not assure future results. Recommendations are subject to change at any time, so members are encouraged to make regular use of the website and pay special attention to Money Map Press updates sent out via e-mail. The publishers, editors, employees or agents are not responsible for errors and/or omissions.

Privacy Notice

You and your family are entitled to review and act on any recommendations made in this document. All Money Map Press publications are protected by copyright. No part of this report may be reproduced by any means (including facsimile) or placed on any electronic medium without written permission from the publisher. Information contained herein is obtained from sources believed to be reliable, but its accuracy cannot be guaranteed. Money Map Press expressly forbids its writers from having a financial interest in any security recommended to its readers. All Money Map Press employees and agents must wait 24 hours after an Internet publication and 72 hours after a print publication is mailed prior to following an initial recommendation. Money Map Press does not act as a personal investment advisor, nor does it advocate the purchase or sale of any security or investment for any specific individual. Investments recommended in this publication should be made only after consulting with your investment advisor, and only after reviewing the prospectus or financial statements of the company.