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Weekly Bond Commentary:

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Inverted curve not an off-ramp for economy

Does an inverted yield curve matter? Does it signal anything?

Markets were focused last week on the latest fad headline, portraying an inverted yield curve as the next big worry. If you recall, last year headline writers bashed the increase in debt rated BBB as the sign of cataclysm. To set the record straight, BBB-rated debt was among the best performers during the first quarter of 2019.

So what is an inverted yield curve? It is a term used to describe an uncommon situation when the yield of longer-dated U.S. Treasuries is lower than that of shorter-dated ones. When it does happen, it is typically the 10-year Treasury compared to either the 2-year Treasury or 3-month Treasury bill. This week, Treasury yields out to 10 years fell below both shorter yields and the federal funds rate.

This matters because the yield curve typically inverts as the economy approaches recession. Driven by Federal Reserve hikes at the front end, the economy begins to slow, causing yields on longer maturity instruments to fall. What headline writers often omit is that past inversions have happened many months before recessions begin, making them poor predictors of timing. Today, there appear to be few signs of imminent recession, with weekly jobless claims near 50-year lows and consumer confidence still high.

For the week, 2-year Treasury yields ended the week at 2.27%, 3-year yields at 2.21% and 5-year yields at 2.23%.