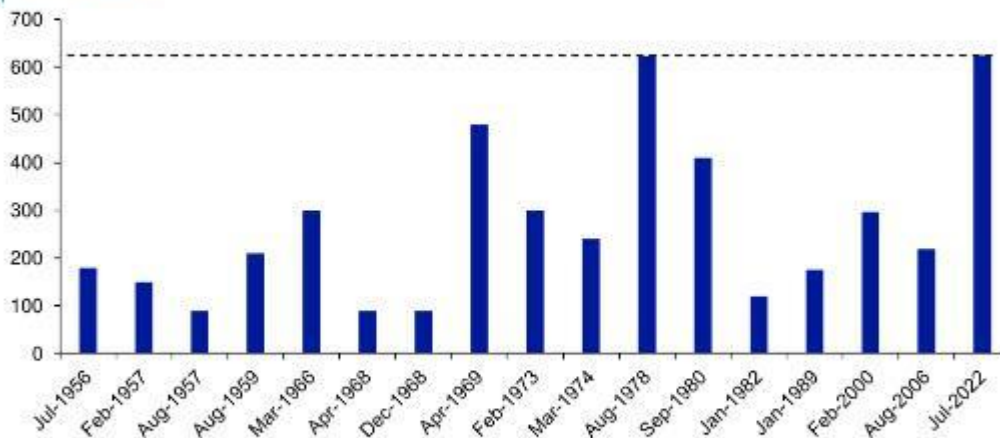




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The Longest Yield Curve Inversion In History

Figure 1 : Length of all US 2s10s yield curve inversions (Days) that were longer than 3 months. The current one is now the longest...



Note: Daily data only available from 1977, for monthly data prior to that it is assumed that one month equals 30 days.
Source: GFD, Bloomberg Finance LP, Deutsche Bank

When the yield curve inverts, meaning shorter-term debt instruments have higher yields than longer-term ones, it's often seen as a warning sign for the economy. This condition has historically preceded recessions, signaling that investors are more pessimistic about the short-term economic outlook than the long-term. An inversion lasting for an exceptionally long period, as recently observed, raises significant discussions about its implications.

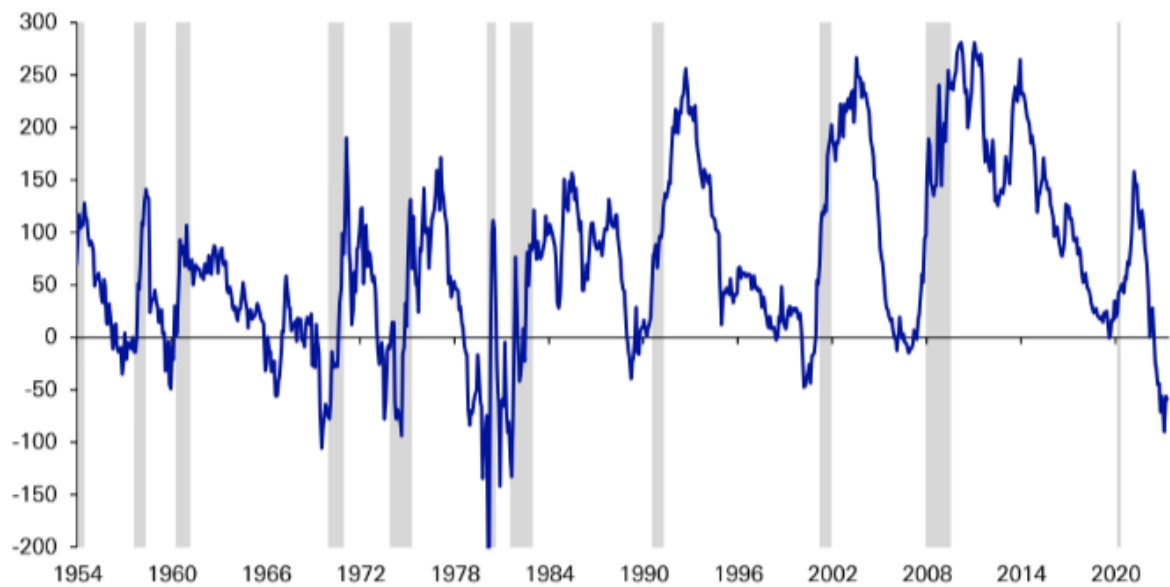
The prolonged inversion challenges traditional expectations, as it has not followed the typical pattern leading directly to a recession.



Historically, the 2s10s yield curve inversion is the most reliable indicator of recessions... usually occurs around 12-18 months later...



US 2s10s Treasury Yield Curve (basis points)



Source: GFD, Bloomberg Finance LP, Haver Analytics, Deutsche Bank

Deutsche Bank
Research

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(GREY AREAS ARE RECESSIONS)

This anomaly could be attributed to several unique factors in the current economic landscape:

1. **Bank Lending and Credit:** The inversion has led to tighter bank lending standards and a decrease in bank credit and money supply. Such conditions usually precede economic downturns by making it harder for businesses and consumers to borrow, thus reducing spending and investment.
2. **Bank Failures:** There have been notable bank failures, partly blamed on investment strategies that faltered due to the inverted yield curve. These failures are significant because they affect the overall stability of the financial system and can lead to tighter credit conditions.

Despite these traditional recession precursors, the economy has shown resilience. Factors contributing to this resilience include:

- **Low Borrowing Needs:** During periods of tight lending standards, the overall demand for borrowing was lower than in previous cycles, which helped mitigate the impact of reduced lending on economic growth.

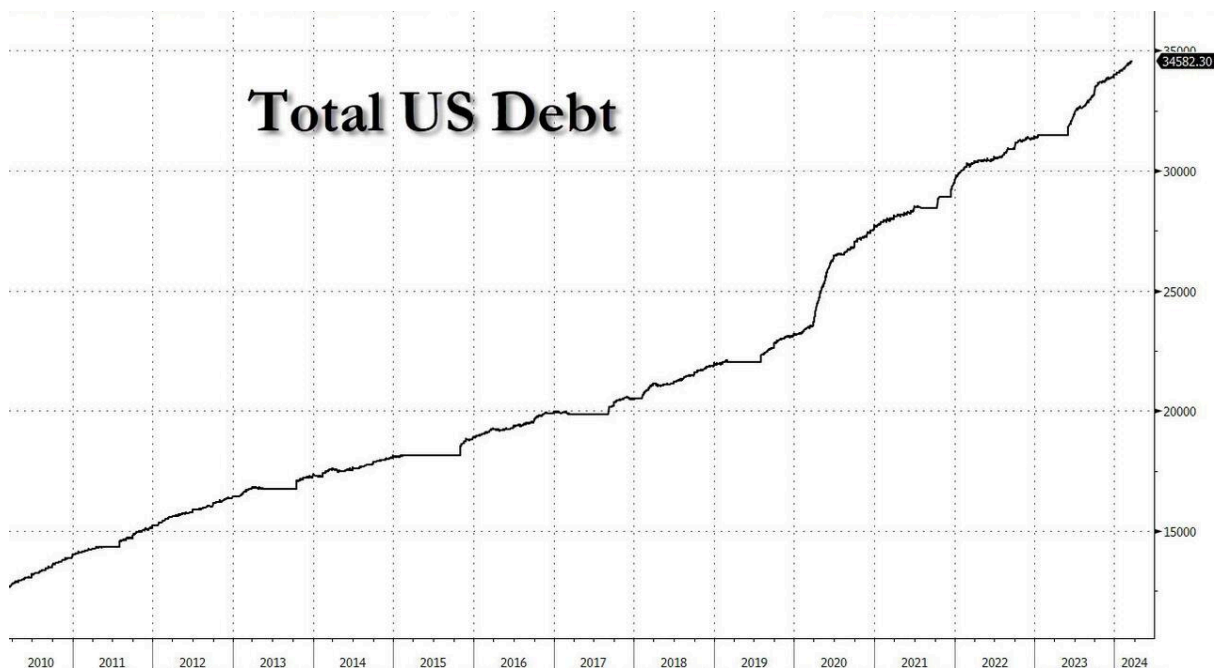


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- **High Consumer Savings:** Consumers have had unusually high savings rates, partly due to fiscal measures and the economic disruptions of the pandemic. This has lessened the impact of tighter credit conditions on consumer spending.
- **Federal Reserve Interventions:** The Federal Reserve has implemented measures to support the banking system and prevent a broader financial crisis. These interventions have helped maintain stability in the financial markets and the broader economy.
- **Supply-Side Recovery:** The supply side of the economy has rebounded strongly from pandemic-induced disruptions, supporting continued economic growth despite monetary tightening.

The inversion of the yield curve typically discourages long-term lending and investment, as investors find less incentive to lock in funds for extended periods when short-term yields are more attractive. This can slow economic growth, as investments in long-term projects and ventures are critical for sustained economic expansion.

However, the unprecedented level of fiscal stimulus and government borrowing has kept the economy buoyant. This scenario is unique, with substantial government deficits coinciding with low unemployment, indicating a robust economic activity level that defies the typical outcomes of a yield curve inversion.



In light of these observations, the underlying message is that while an inverted yield curve remains a critical indicator to watch, its implications can vary depending on broader economic conditions and policy responses. The return to a normal, upward-sloping yield curve is generally seen as beneficial for the economy, encouraging more traditional investment behaviors and contributing to financial system stability.



Glossary

- **Yield Curve:** A graph showing the interest rates of bonds with equal credit quality but different maturity dates. Normally, longer-term bonds have higher yields.
- **Inversion of the Yield Curve:** This happens when short-term bonds have higher yields than long-term bonds, which is not typical. It's often seen as a predictor of economic downturns.
- **2s10s Inversion:** Specifically refers to the 2-year Treasury bond yield being higher than the 10-year Treasury bond yield.
- **Recession:** A significant decline in economic activity spread across the economy, lasting more than a few months.



FED: 3 RATE CUTS IN 2024

Understanding the impact of the Federal Reserve's decision to cut interest rates three times this year requires a grasp of how interest rates influence various sectors of the economy. Interest rate cuts generally aim to stimulate economic activity by making borrowing cheaper, encouraging spending and investment. Here's a look at sectors likely to benefit from these rate cuts:

Real Estate and Housing

Lower interest rates decrease the cost of obtaining mortgages, making it more affordable for consumers to buy homes. This increase in homebuying activity can boost the real estate market. Additionally, real estate investment trusts (REITs) may see improved performance as financing costs decrease and property values potentially rise.

Consumer Discretionary

This sector includes companies involved in the production or sale of non-essential goods and services, such as luxury goods, automobiles, and entertainment. Lower interest rates increase consumer spending power, as loans for big-ticket items become cheaper and individuals have more disposable income. This can lead to higher sales and profits for companies in the consumer discretionary sector.

Financials

The impact on the financial sector can be mixed. On one hand, lower interest rates can narrow the margin between what banks earn on loans and what they pay on deposits. On the other hand, the increased activity in loans and mortgages, especially in sectors like real estate, can offset these effects. Additionally, lower rates can lead to higher market liquidity and potentially more transactions and services from which financial institutions can benefit.

Technology

Technology companies, especially those with high growth potential, can benefit from lower interest rates. These companies often rely on borrowing to fund research, development, and expansion efforts. Cheaper borrowing costs can accelerate their growth projects. Furthermore, investors often flock to growth stocks, like tech, when bonds and savings accounts yield lower returns due to rate cuts.

Utilities

Utilities is another sector that tends to benefit from lower interest rates. Utilities companies are known for their high dividend yields, and as rates fall, these dividends become more attractive to investors seeking income. Additionally, utilities often carry significant debt due to



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the capital-intensive nature of their business, so lower interest rates can reduce their borrowing costs.

Healthcare

The healthcare sector can also see benefits from lower interest rates. Like technology, healthcare companies, particularly those in biotech or requiring significant investment in research and development, can take advantage of cheaper financing. This can support their growth and development of new treatments or products.

Manufacturing and Infrastructure

Lower interest rates can stimulate investment in manufacturing and infrastructure. These sectors often require significant capital expenditure, and cheaper financing can make such investments more viable. This can lead to job creation and broader economic growth.

Overall Economic Growth

Generally, the Federal Reserve's decision to cut interest rates is designed to stimulate economic growth by making borrowing cheaper and encouraging spending. While some sectors may benefit more directly than others, the overall aim is to support a more robust economic environment.

In conclusion, the Federal Reserve's planned rate cuts can have a broad impact across various sectors, with particularly positive effects on real estate, consumer discretionary, and high-growth areas like technology and healthcare. These moves are aimed at stimulating economic activity and fostering conditions that support business expansion and consumer spending.