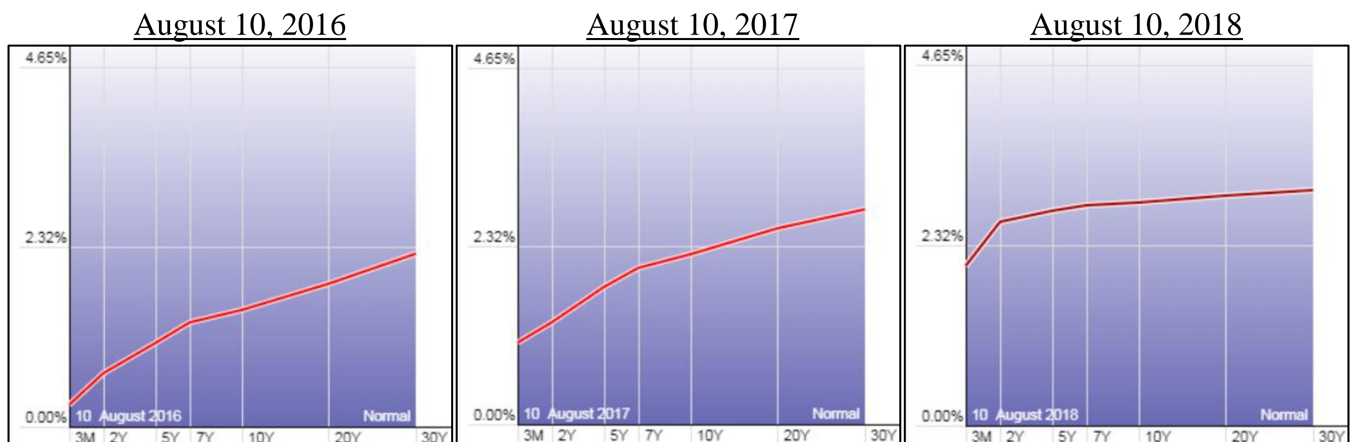
VOISARD
ASSET MANAGEMENT GROUP

Yield Curve
August 28, 2018

If you pay attention to the yield curve (the "curve"), you have noticed an interesting change over the last two years…it has flattened substantially! Before we go into what this could mean for the economy, let's talk about what the curve represents. The curve is a graph that charts the interest rate you will receive in purchasing government treasury bonds of differing maturities. The interest rate is charted along the y-axis, and the length of time before you are repaid is represented by the x-axis. In a normal yield curve, you will see the line slope upward. This means that you will be paid higher interest rates if you lend your money to the government for longer periods of time. This makes sense, as we would expect to earn a higher interest rate for lending funds for a longer period of time.

Why Do We Care About the Yield Curve?

The reason we care about the curve is actually quite simple. The curve has historically reflected the market's sense of the economy. If it is upward sloping, the market thinks that things are going to be good or better in the future. Once the curve inverts, it reflects the opposite sentiment. This has become a key market indicator as the curve has inverted prior to the past seven recessions.



What Does It Mean?

As you can see from the graphs above, although the curve has been flattening, it is not inverted. It is important to note that even if it does become inverted, an inverted yield curve does not cause a recession. Inversion is usually a signal of a bigger symptom: the Federal Reserve driving short-term rates too high and an overtightening of monetary policy. Based on current market conditions, this does not appear to be the case. Economic growth is at its highest point in years, and the Fed has at times appeared slow in raising interest rates.

Because of these factors, it is our belief that long-term interest rates will continue to rise, bringing us back to a more normal yield curve. However, even if the opposite occurs, and we do enter a recession, our portfolios are well suited to handle the market's volatility. Some investors will try to time the market if an inversion occurs, but market timing usually tends to lead to missed opportunities and poor returns. This is why we believe our clients should stay the course and stick to their individualized financial plan through market turmoil. Given the potential for uncertainty ahead, it becomes even more important to ensure you have a well-constructed, diversified portfolio to weather any market storm.

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