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Recession looming?

The inversion of the yield curve is usually a very strong signal that an economic recession is brewing. In the United States short-term rates have been pushed above longer-term yields, and jitters begin to be felt in the financial community. There are, however, economists who do not agree with this thesis. They claim that the most important sign to look at is that investors are still very much attracted to US fixed income, a clear indication of a still strong economy. As a matter of fact, bond prices have indeed gone higher.

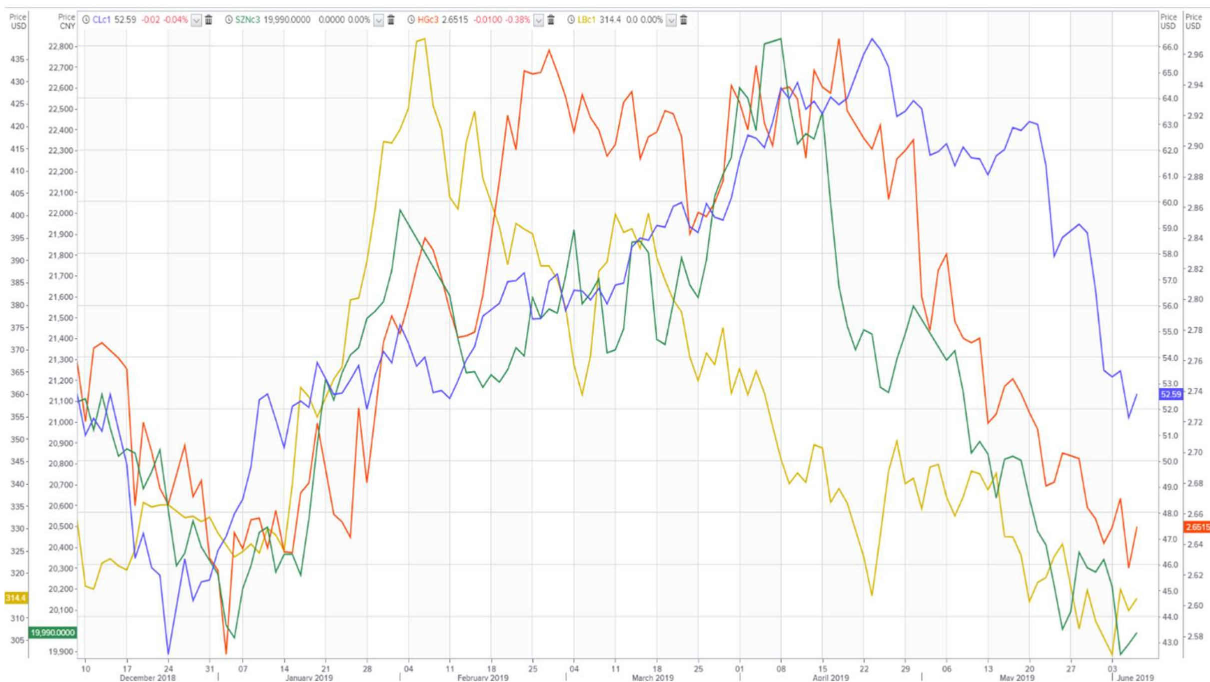
Maybe so, but we cannot overlook other signs of weakness. For example:

1. Falling commodities.

Oil has always been seen as most important because strictly related to a healthy economy. What have we witnessed these past weeks? Correct, a steep decline.

Zinc and copper have been following the above-mentioned negative trend: 8.5% and 6% respectively in the month of May alone. They are important because they represent main components in both tech and industrial enterprises.

Shall we talk about lumber? 10% down in May. This is an early indication of a deterioration of the housing market in the United States, as much as for the time being house construction is still positive.



Source: Reuters

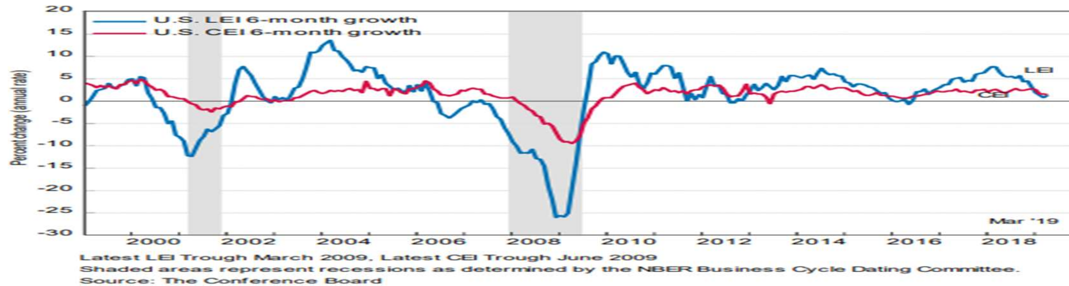
2. Manufacturing is slowing down.

At 52.10 for the month of May 2019 the ISM PMI Manufacturing Index fell to some of the lowest levels, very close to the 52.0 seen in September 2016. Could it be an important sign that the commercial war with China is starting to take its toll?

Source Tradingview.com

3. Leading Economic Index (LEI) and Coincident Economic Index (CEI).

The LEI index incorporates 10 important gauges for a healthy economy (such as manufacturing new orders, weekly jobless claims, housing building permits, consumer sentiment and stock prices being the most relevant). It's not inverting its trend yet, but it only rose 2.7% since April: the weakest since early 2017. Last year alone it was up a comfortable 7%. It will be extremely important to monitor the LEI because recessions usually unfold shortly after decline, like in 2010. The CEI Index, on the other hand, includes only four statistics (number of non-farm employees, the industrial production, the level of manufacturing and trade sales and the aggregate amount of personal income).



Yes, the job market is still strong so far, but the above indicators might announce signs of a significant slowdown. The trade dispute President Trump has just staged with Mexico for higher import tariffs (currently on hold) only adds to the China "spat" we have been witnessing since March, which in turns further adds to the winds of war with Iran. A very clear additional point of instability. As indicated at the very beginning, there are however, market participants who do not marry the thesis of a possible recession.

Should the United States enter recession sometimes in the first quarter of 2020 it could be such a bad event that not even a presidential "tweet" might calm things down before November. Is it too late already?

Economic cycles come and go, we all know that. Governmental policies too, and they usually follow the economy, but will the voting citizen understand that in November 2020, or will he still be a staunch ideological partisan? I firmly believe that the old say "It's the economy, stupid" will still be very much relevant come November of next year.

We have, after all, been witnessing a very solid ten year of growth. Is a change about to take place? I wouldn't be too surprised if that will occur. Perhaps a slight reduction in the stock portfolio would be a safe and prudent step to take.

Marcello Tedeschi, June 25, 2019