CASTLE ROCK
WEALTH MANAGEMENT

Registered Investment Advisor Firm

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Inversion Recession

In my April 2019 newsletter, yield-curve inversion history is mentioned. I thought more history and what the FED needs to do to avoid a recession would put history in prospective.

Recessions are inevitable, but when, duration and depth are the questions. Also, outside events, like wars or other financial catastrophes can't be forecasted or predicted.

One of the most reliable harbingers of US recession – short-term interest rates on US Treasury debt higher than longer-term yields – has been flashing warning signs for months. That doesn't mean the economy is doomed to an immediate downturn, there is usually a 12 to 16 month lag.

Yield curve inversions have preceded every US downturn since the 1950's, with only one false positive in 1966. Recently, the yield on two-year Treasuries briefly surpassed the yield on 10-year notes again. Traders believe the FED needs to lower interest rates.

According to the latest survey from the National Association for Business Economics, 38% of the 226 economists surveyed peg the start of the recession in late 2020, down from 42% in the February survey, and 34% expect the recession will begin in 2021, up from 25% in February. Only 2% expect the recession will begin this year.

The good news is that the US Consumer remains healthy. Household spending excluding groceries and energy is rising about 4% a year, the fastest sustaining pace since 2007. Worker pay is rising even faster, at about 5% annually, which means today's growth is not dependent on rising household indebtedness. July's consumption remains robust, so it is hard to imagine a recession beginning under these circumstances. Historically, the S&P 500 Index has rallied an average of 22% from the first inversion to the eventual economic peak.

The bad news is that the strong wage gains are coming at the expense of corporate profitability, which has likely contributed to the recent weakness in

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business investment. The Commerce Department's national income data has been flat since 2016 and is down about 15% from the peak at the end of 2014. Rising profits justify rising capital spending. Stagnant profits do not. Global industrial production is slowing. European consumption is slowing. European investment spending is slowing. Trade conflict is discouraging capital spending.

The central bank overestimated the strength of the US economy in 2018. Officials wrongly believed substantial interest-rate increases would be needed in 2018, 2019 and 2020 to prevent "overheating", which raised borrowing costs, depressed stock prices and inverted the yield curve.

This policy tightening had the predictable effects. Residential construction spending fell, core retail spending stagnated and the job market started cooling.

FED officials quickly recognized their error and began to reverse course at the start of 2019. In July, they lowered interest rates for the first time since the financial crisis. If the FED follows the 1994-1996 history, we can avoid a recession. The FED raised rates in 1994 and 1995, and in 1996 they started lowering rates because the economy was slowing. By the end of 1996 after several rate decreases, US production and spending growth reaccelerated while the job market quickly returned to new heights. The expansion lasted at least another half-decade.

Can the FED repeat?

If you need help with understanding yield curve inversions or recessions or any other financial questions, contact me at (707) 648-2024.

Q: What is the latest Social Security phone scam?

A: Social Security's acting inspector general issued a warning about an ongoing caller-ID "spoofing" scheme that is misusing the Social Security Administration's national customer-service phone number. The agency has received many reports from across the US of questionable calls that appear to come from the agency's number: 800-772-1213. If you receive such a call that you suspect is a scammer claiming to be from Social Security, do not engage with the caller and don't provide any personal information. If you're not sure, you can always hang up and call the Social Security Administration back yourself. Report suspicious calls to the agency's Office of the Inspector General at 800-269-0271 or https://oig.ssa.gov/report.

FED Watch

At the September FOMC meeting, the FED lowered interest rates to 1.75% to 2.0%; in an effort to stave off a possible recession triggered by a global economic slowdown and a US trade war with China.

The FED also signaled the strong possibility of another rate cut later this year, citing "uncertainties" about the outlook and vowing to "act as appropriate to sustain the expansion."

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There is a 53% probability of a quarter point drop at the October meeting and a 51% probability of a quarter point drop at the December meeting and a 21% probability of a half point drop.

Next meeting:
October 29th and 30th.

Castle Rock Wealth Management

Castle Rock Wealth Management is a Hybrid Advisory firm servicing the needs of clients across the United States.

Castle Rock Wealth Management custodies some client assets at Charles Schwab & Co. Bob's office is located at 714 Marin Street, Suite #C, Vallejo, CA 94590. The telephone number is (707) 648-2024.

If you have questions or would like further information on this month's topics or any other financial or investment related subjects, please contact me by phone or through my email address at:
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