After The Close

Tremors across the bond market cause equities to quake

Anthony M. Saglimbene, *Global Market Strategist*
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Global recession warnings continue to flash yellow

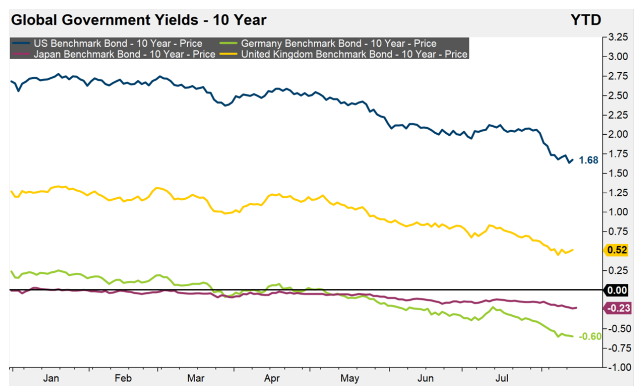
Major Domestic Equity Indices - Today			
Benchmark	**Index Level**	**Net Change**	**% Change**
S&P 500 Index	2,841	-85.7	-2.9%
Dow Jones Industrial Average	25,479	-801.2	-3.1%
Russell 2000 Index	1,468	-43.1	-2.9%
NASDAQ Composite	7,774	-242.4	-3.0%

All data via FactSet as of approximately 4 PM ET

Bond markets reminded investors today that all is not well in the world, at least from a global perspective. Economic activity and profit growth are on the decline, and an escalating U.S./China trade war has fueled a contraction in global manufacturing, thus souring investment sentiment. For several months, market participants have been closely watching technical aspects in the bond market. Inversions across the yield curve (i.e., where longer-term interest rates move below shorter-term interest rates) can indicate early warning signs of economic downturns. Clearly, lending money for a longer period of time should net investors more return than lending money over a shorter window of time. However, when yield curves invert, the exact opposite is taking place – and the dynamic is far from normal.

Although the spread between the 10-Year/3-Month U.S. Treasury has been inverted since April, only today did the more closely followed 10-Year/2-Year spread finally cross into negative territory. As a result, this is the first time the 10/2s spread has inverted since 2007 and before the financial crisis. Unfortunately, the last five inversions in this part of the curve have been followed by a U.S. recession. Historically, a recession has occurred on average 18 – 24 months following an inversion in the 10/2s spread. For investors, the inversion in the 10/2s spread adds yet another concern to the growing list of market troubles and is a reason to be more cautious on risk assets. Historically, the S&P 500 Index 'gains' on average +12% over the next year following a 10/2s inversion. In our view, a U.S. recession still sits out into the future. Nevertheless, the market reacted negatively today to a 'recession warning clock' that started to tick louder.

Importantly, we would use extreme caution when looking at inverted yield curves, recession timing, and subsequent asset price direction. Today, stocks, as well as a myriad of other asset types, incorporate market developments almost instantaneously. The speed at which information moves and the degree that historical trends can be refected and reacted to across trading strategies, in our view, means the norms of the past may hold less water in shaping asset prices in the future. Bottom line: The bond market is telling investors there are meaningful concerns about the growth outlook. In our view, the equity market has started to take notice and may continue to do so whether a recession occurs or not. As the *FactSet chart* below (through yesterday) illustrates, global bond yields continue to fall, with some government bond yields in negative territory – another abnormal function playing out across bond markets at the moment.



On the day

Despite Tuesday's positive news that the White House will delay tariffs on important holiday items, and the U.S. and China will continue trade discussions next month, global equities sank on Wednesday. All 11 S&P 500 sectors were lower, with Utilities the relative outperformer. Weakness across Energy (i.e., lower oil demand) and Financials (i.e., lower interest rates) were pronounced. The 10-year Treasury yield sank to 1.58%, as bond prices surged and gold moved higher.

Committee View

The next FOMC meeting isn't scheduled until the end of September, and Fed officials have said they do not want to be responsible for a yield curve inversion, particularly if it starts to have a more pronounced impact on the economy. A 25 or 50 basis point cut in the Fed Funds target rate could press shorter-term rates lower, which could help 'un-invert' portions of the Treasury curve and possibly boost investor confidence. Though a further inversion in the yield curve may prompt some market participants to call for an intra-meeting cut, such a move could cause more alarm than good among investors, in our view. **As we highlighted on Monday, this is the time for all investors to be more cautious, avoid rash decisions, and lean on the principles of diversification. With that said, equities may be entering an oversold technical condition over the near-term. Amid high volatility, and lower trading volumes, we believe the market may struggle to find an equilibrium level over the coming weeks.**

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Ameriprise Financial
1441 West Long Lake Road, Suite 250, Troy, MI 48098
Investment.research.group@ampf.com
For additional information, or to locate your nearest branch office, visit ameriprise.com

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