# Recession or Slower Growth?

*Is the US Economy Headed for a Recession in 2019?*

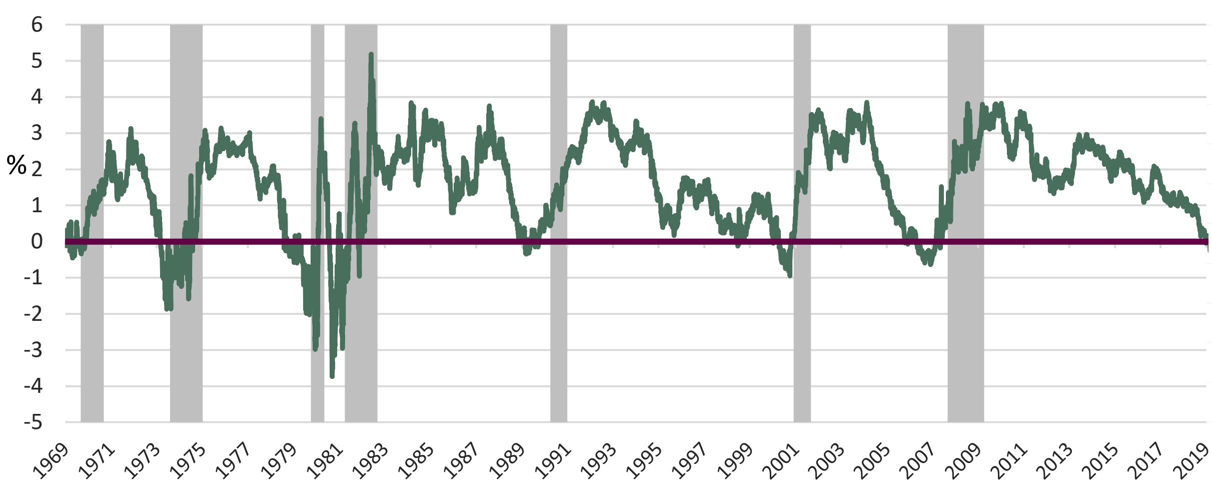
**A popular recession warning has been flashing red recently as the yield on the 10-year US Treasury notes dipped below the yield on 3-month US Treasury bills, known as a yield curve inversion, for the first time since 2006-07.** Historically, a recession is likely to follow a prolonged inversion of the yield curve approximately 8 months to 2 years later. Recent inversions, the first of which occurred immediately following the March Federal Open Market Committee (FOMC) meeting where the FOMC left short-term interest rates unchanged, was a shallow inversion that only lasted about a week, followed by additional inversions in May and June. Could this signal the end of one of the longest US economic expansions in history, or is the US economy resilient enough to withstand a slowdown in global growth and escalation of the trade war? While the inversion is noteworthy and indicative of increased risks to the US economy and a possible slowdown in future economic growth, to further answer this question we can evaluate additional economic data. In assessing the risk of a recession, we believe there are two additional bellwether leading indicators for the US economy that have exhibited strong predictive value in the past: The Conference Board's Leading Economic Index (LEI) and the percentage change in the level of the monetary base.

**RECESSIONS IN RECENT HISTORY**

- **Early 1990's Recession**
  *July 1990-March 1991*
- **Dot-com Bubble Recession**
  *March 2001-November 2001*
- **Subprime Mortgage Crisis Recession**
  *December 2007-June 2009*

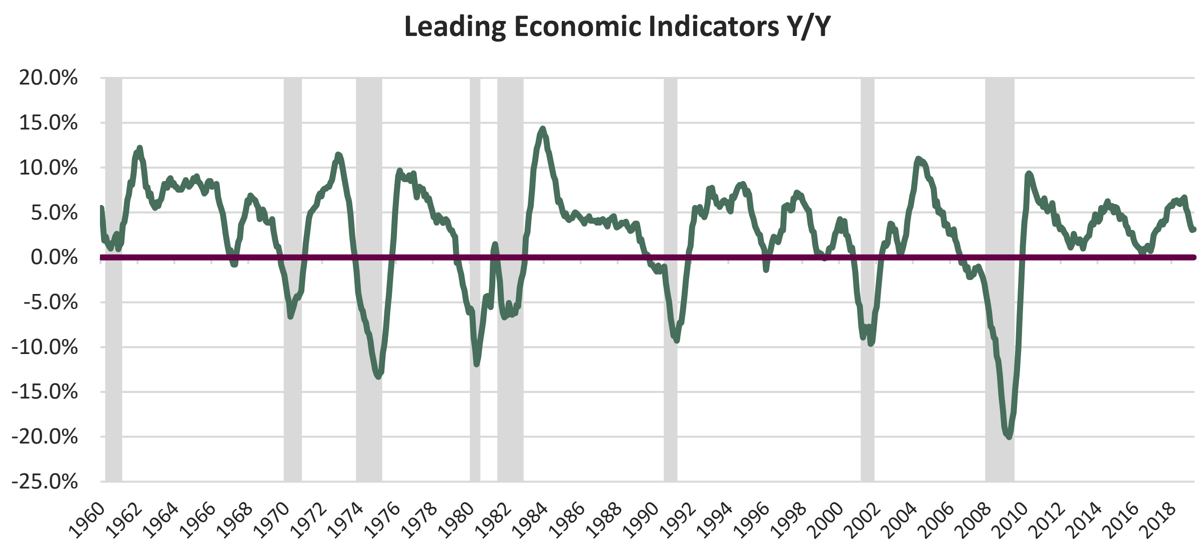
*NBER peak to trough recession dates.*

**Historical Spread Between 10 Year & 3 Month US Treasuries**




*Sources: Bloomberg. Shading denotes National Bureau of Economic Research (NBER) recessions.*

The Conference Board's Leading Economic Index (LEI) includes ten components that are considered leading indicators. Examples of components include *new manufacturing orders, building permits, employment data,* and *stock and bond valuations*. In 5 out of the last 7 recessions, the year-over-year change in the LEI turned negative at least 2 consecutive months just prior to the recession. Although recent year-over-year readings of the LEI have been trending downward, it still increased by 2.7% on a year-over-year basis as of April 30, 2019. This indicator is running contrary to the yield curve inversion and is currently signaling the U.S. economic expansion should continue in the near term.

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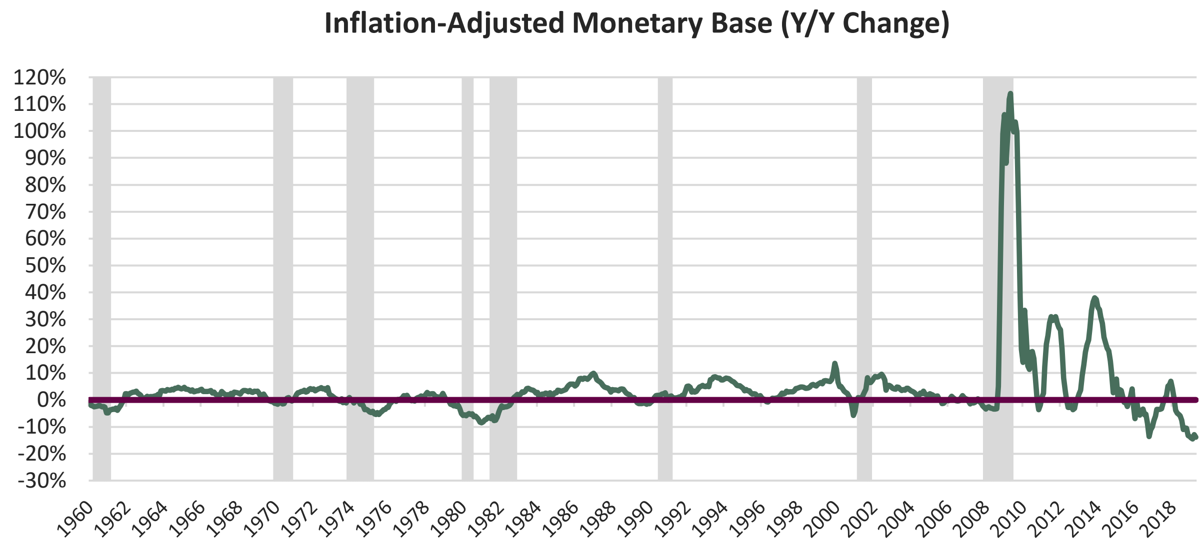
Another indicator investors can evaluate is the percentage change in the level of the monetary base, which is an important factor in economic growth and provides additional insight to measure the health of the US economy and recession risk. An increase in the monetary aggregate is indicative of accommodative monetary policy by the Federal Reserve (Fed). Decreasing monetary aggregate levels imply tighter economic conditions and heightened recession risk. Every recession in the last 70 years was preceded by a negative change to the inflation-adjusted monetary base on a year-over-year basis. Recently, this metric has been negative due in part to the Fed's balance sheet reduction program which was incepted in October 2017 and is scheduled to conclude at the end of September. The Fed is expected to shrink its balance sheet from its peak size of approximately $4.5 trillion to around $3.5 trillion. There will likely be less negative pressure on this indicator starting in Q419 as the Fed balance sheet levels off.

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Overall, US recession risk has increased, and it is important to note that our analysis incorporates many different factors in addition to the three prominent leading indicators detailed in this article. Should all three indicators of recession begin to run persistently negative, we would likely conclude risks have increased to a point that a recession is imminent. For the time being, however, we continue to believe US economic fundamentals remain intact. Importantly, the LEI remains positive year-over-year and the Fed plans on terminating its balance sheet reduction program in September 2019 which will relieve pressure on the year-over-year change in the Inflation-Adjusted Monetary Base. Furthermore, financial conditions are not restrictive, and the Fed has a dovish stance. Nevertheless, we are watching the incoming economic data and trade developments closely and believe risks to the global economy have increased but do not expect a U.S. recession in the near term. We are continuously updating our view on the US economy and financial markets as additional information becomes available, and may revise our outlook if the data starts to turn starkly negative.

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***Questions?***

Please contact Chandler at info@chandlerasset.com, or toll free at 800-317-4747 with any questions or to learn about investment management solutions for public entity investment programs.