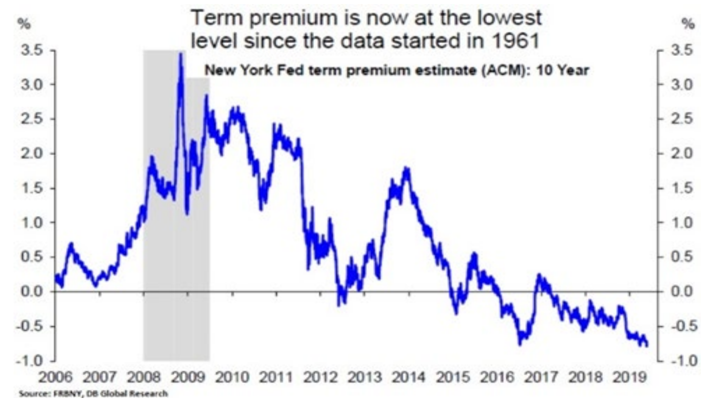
BLOG POST

Analyst Corner
Part 2
July 29, 2019

Fixed Income – Vanishing Term Premium

In June the term premium, the amount of excess interest investors demand to own long-term bonds rather than shorter durations, slipped to the lowest level since the data was made available starting in 1961. When relationships as basic to the understanding of macroeconomics like interest rates and duration break 50-year records it is worth taking note. Inflation is generally regarded as the benchmark for the term premium. Higher future expectations for inflation results in a higher term premium. If accurate, the chart would be forecasting a long period of deflation, the Fed's worst nightmare. Today's negative term premium is more likely the result of an imbalance between supply and demand in the Treasury market. Future uncertainty is high, raising demand for longer duration Treasuries to hedge the risk of economic contraction. This illustrates the strange times we are in.



Technical – Charting Confidence

Technical indicators like trend following are typically applied to asset prices, but can be just as valuable at predicting the future of the economic growth or corporate spending if the indicators are reliable. The ISM manufacturing data is considered a valuable "leading indicator" as it has historically identified inflection points in the economy. The correlation over the past 15 years shows that CEO confidence has a correlation above 85% to ISM data. CEO confidence could be considered a leading indicator to a leading indicator. Since the escalation of the trade dispute with China in mid-2018, CEO confidence has plummeted even if the latest reading showed a slight bounce. If historical correlations remain intact, the ISM data will move into contraction territory below 50 over the next couple of months. Exports to China are less important to CEOs than their supply chain, creating consternation.