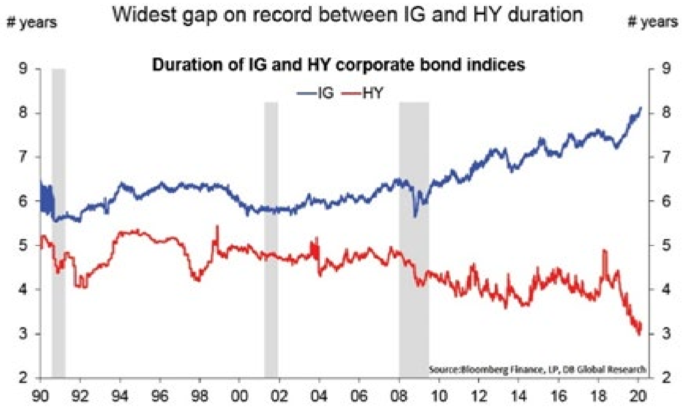
BLOG POST
Analyst Corner
Part 2
3/19/2020

Fixed Income - Risk Off in Disguise

Equity markets hit all-time highs in February, making it is easy to assume we have been living in a risk-on world until panic over the COVID-19 showed up. The bond market has been flashing an early warning sign for more than a year as evidenced by the chart below. The two most common measures of risk with fixed income are credit quality (default risk) and duration. The longer the duration, the more uncertainty investors are subjected to. Investment-grade companies with low default risk have been taking advantage of historically low rates to lock in long-term durations. The market's pricing of risk for high yield companies is driving durations lower, to the lowest level in 30 years. The duration spread between IG and HY is now the widest on record at 5 years after averaging just 2 years for more than 20 years.



Technical - Warning Signs from States

One of the most accurate predictors of a recession in the United States is the relative level of economic activity on a state-by-state basis. The U.S. economy is nothing more than the sum of each of the 50 states' economic activity. History has suggested that when too many states experience negative economic growth, the nation's economy will ultimately follow. Over the last 30 years, whenever more than 30 individual states experienced economic contraction a recession followed. As we near the end of Q1, the number of states with contracting economies is right at the threshold of signaling a tipping of the economy into recession. This would suggest even a modest slowdown from COVID-19, particularly in states that benefit from exports to China, could become the tipping point to a U.S. recession. No indicator or trend is fool-proof, but we are watching this closely for signs of contraction.