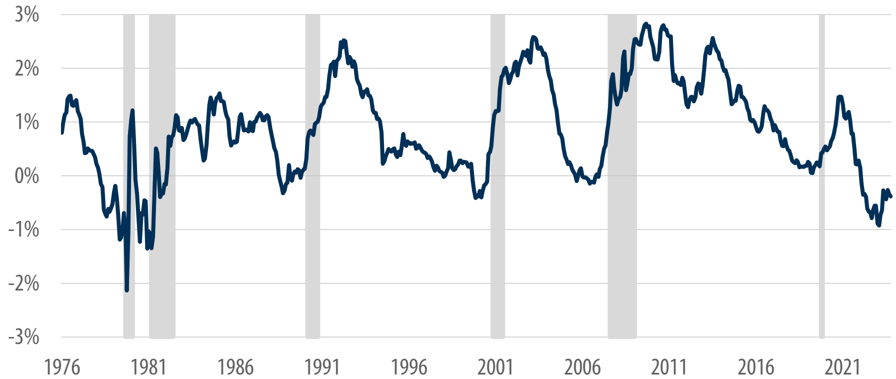
March 28, 2024

In this week's "Three on Thursday," we dive into the U.S. treasury yield curve. The yield curve is a visual representation of how much it costs to borrow money for different periods of time; it shows interest rates on U.S. Treasury debt at different maturities, at a given point in time. Yield curves come in three forms: normal, flat, and inverted. A normal curve, sloping upwards, suggests healthy economic conditions, with investors expecting higher returns for longer-term loans. A flat curve indicates little difference between short and long-term rates, hinting at economic transition. An inverted curve, where long-term rates dip below short-term, often signals an upcoming recession. Currently, the U.S. yield curve, looking at the 10-year yield minus the 2-year yield, has been inverted for a record 630 days as of this Wednesday, a trend raising eyebrows. For more insights, we've included three charts below.

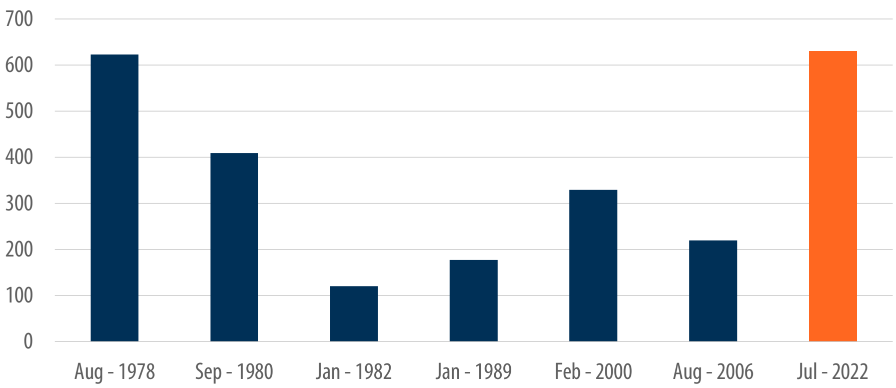
10-Yr Treasury Constant Maturity Minus 2-Yr Treasury Constant Maturity



Source: Federal Reserve Bank of St. Louis, First Trust Advisors. Monthly data 6/1976 - 2/2024.

The most popular and closely watched yield curve inversion occurs between the yields of 10-year and 2-year U.S. Treasury notes. When the yield on the 2-year Treasury exceeds the yield on the 10-year Treasury, it suggests that investors have more confidence in the near-term economy than in the long-term outlook. This inversion reflects concerns about long-term economic growth and is often interpreted as a signal that a recession may be on the horizon within the next one to two years. Back on July 6, 2022 the 2-year treasury yield exceeded the yield on the 10- year treasury and has remained inverted since, with the difference sitting at -0.34% as of Wednesday's close. Financial markets and policymakers closely monitor this measure due to its historical accuracy in predicting downturns.

Length of All 2 Yr - 10 Yr Inversions Greater than 30 Days



Source: Federal Reserve Bank of St. Louis, First Trust Advisors. Daily data 1976 - 2024.

Looking back over history, the current inversion of the 2's and 10's has been the longest on record, currently sitting at 630 days as of Wednesday (3/27/24), more than double the average length of inversion going back to 1976. On March 21st, the current inversion surpassed the previous longest inversion which started back in August 1978 and lasted 623 days. It's important to note the current inversion is the first one since the Federal Reserve changed the way they influence interest rates by switching to an abundant reserve monetary policy after the Great Financial Crisis. Time will tell if the current inversion will once again have the same relationship as it has through history.

Long and Variable Lags

Start of Inversion	End of Inversion	Start of Recession	End of Recession	Months From Inversion to Recession	S&P 500 Index All Time High After Inversion
Aug - 1978	May - 1980	Jan - 1980	Jul - 1980	17	N/A
Sep - 1980	Oct - 1981	Jul - 1981	Nov - 1982	10	11/28/1980
Jan - 1989	Jun - 1989	Jul -1990	Mar - 1991	18	6/4/1990
Feb - 2000	Dec - 2000	Mar - 2001	Nov - 2001	13	3/24/2000
Aug - 2006	Mar - 2007	Dec - 2007	Jun - 2009	16	10/9/2007
			Mean	**15**	
			Median	**16**	
Jul - 2022	TBD	TBD		TBD	3/21/2024

Source: Bloomberg, NBER, First Trust Advisors. Inversions that occurred after recession started were not counted.

Since 1976, there have been six times where the yield curve has inverted for more than 30 days. Each time a recession followed, with the only exception being the 1982 inversion where the economy was already in recession. The average lead time from inversion to recession is 15 months, with a minimum lead time of 10 months and maximum of 18 months. Notably, the S&P 500 Index hit a new all-time high during four out of the five inversion periods where a recession followed. As of today, we do not believe we are in a recession, but believe we could slip into one by year end.