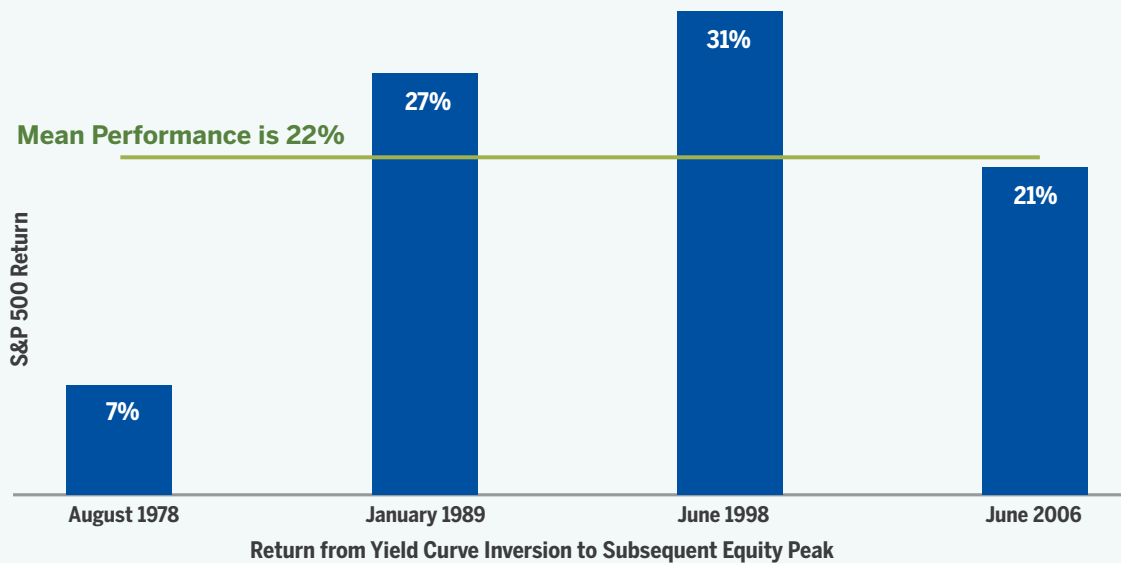


Spooky Curve?

A topical discussion in many publications may have you “spooked”: the U.S. yield curve has been flattening. However, it is important to note that even if the yield curve does invert, U.S. equity markets may first deliver a “treat.” In fact, over the past few decades, investors who sold equities immediately after the yield curve inverted, in advance of an expected “trick,” would have missed out on material gains.

Equity Performance after Initial Yield Curve Inversion



Source: FactSet, St. Louis Federal Reserve, Alger.
Equity performance reflects S&P 500 price change. Dates reflect a negative spread between the 10-year and 2-year Treasury notes.

- The yield curve is a powerful signal for markets and the economy. An inversion in the curve (negative spread between the 10-year and 2-year Treasury note yields) often signals a recession. However, it is also an early signal, with inversion historically occurring nearly two years prior to recessions on average in the U.S. Thus equity investors, prior to these recessions, would have received an average 22% return through the following equity peak.
- Additionally, there is new evidence that suggests that other measures of the yield curve do a better job at forecasting recessions (see Alger on the Money “A New Curve?”). In fact, the signaling mechanism of the yield curve may be impaired when starting at very low levels of interest rates, similar to what has been experienced in the U.S.
- Experienced investors understand there are many ways to assess future market potential and the most successful investors understand that in the long run, individual company fundamentals are the most important factors to consider.

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