

# **Inverted Yield Curve**

**An Indicator to the Next Recession**

**Yiming Zhang**

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**To Investment Committees**

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## Structure of Analysis

01 Yield Curve Overview

02 Reasons We Care About Inverted Curve

03 Action Plans

04 Decision Matrix

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# Inverted Yield Curve? Powell's Response on March 21

## Look at Short-Term Treasury Yield Curve for Recession Risk



March 21, 2022

38th Annual Economic Policy Conference National  
Association for Business Economics

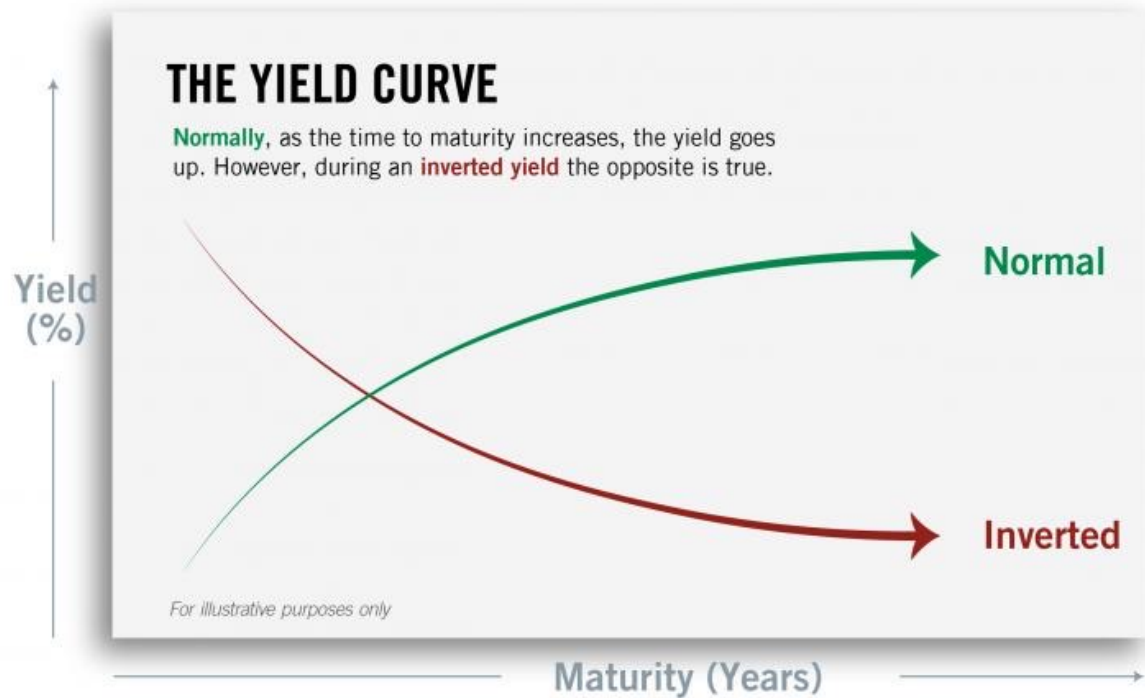
“

...look at the short – the first 18 months – of the yield curve...if it's **inverted**, that means the Fed's going to cut, which means the economy is weak.

”

# Yield Curve: Interest Rates by Different Maturities

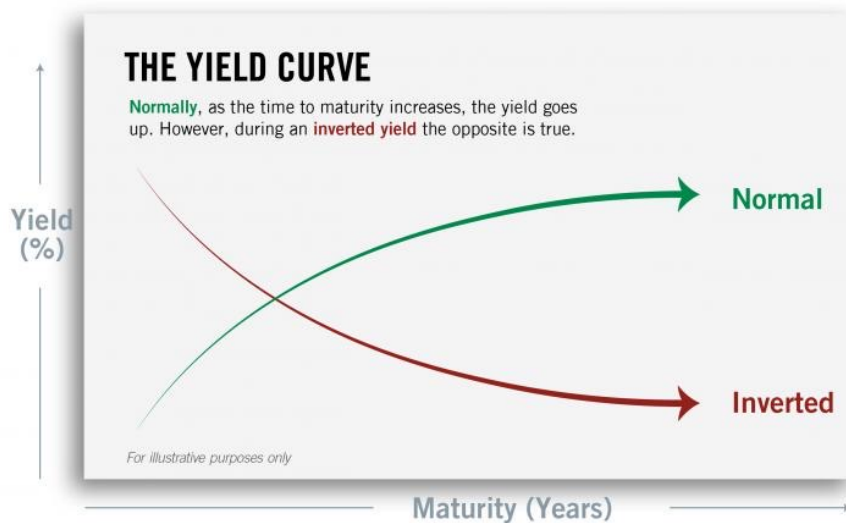
## Different Shapes



Source: PGIM Global Communications

# Yield Curve: Interest Rates by Different Maturities

## Logic Behind Normal Shape



Source: PGIM Global Communications

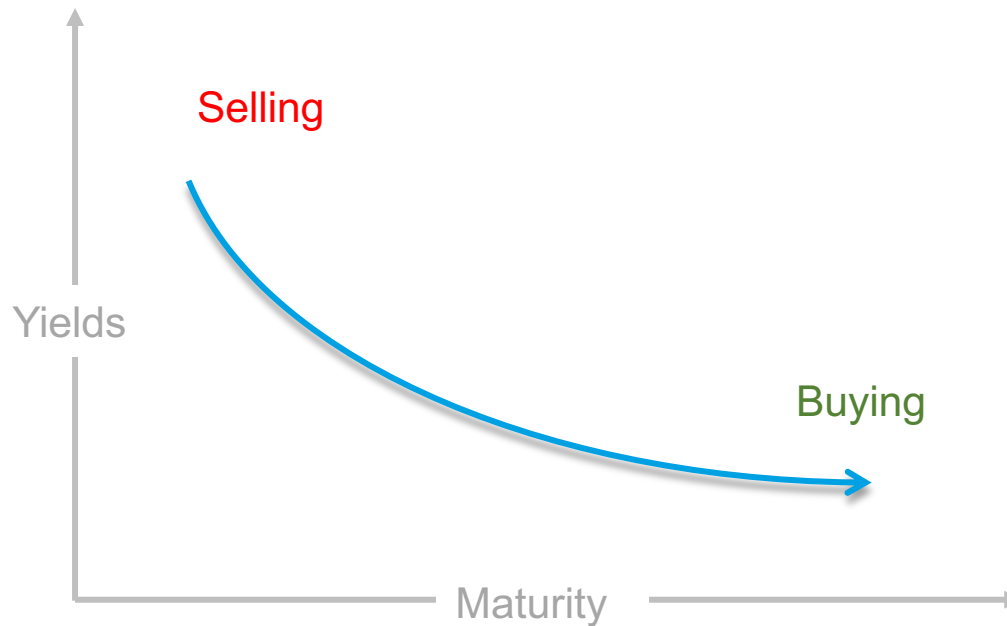
### Normal shape

- Higher liquidity compensation over time
- Higher compensation for defaults

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# Yield Curve: Interest Rates by Different Maturities

## Logic Behind Inverted Shape

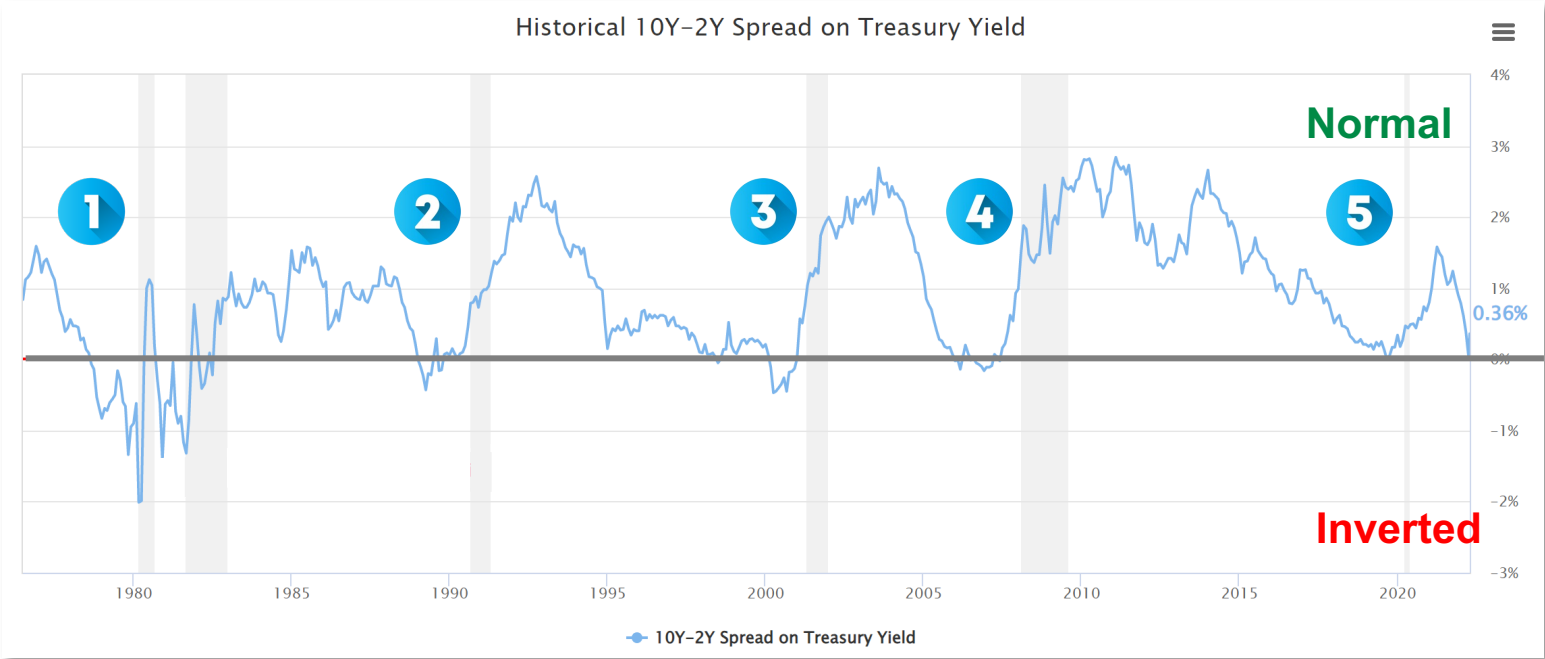


### Inverted shape

- Worry about the recession
- Expect rate cuts
- Prefer Long-term bonds to lock the yields today

# Historical Evidence of the Inverted Yield Curve

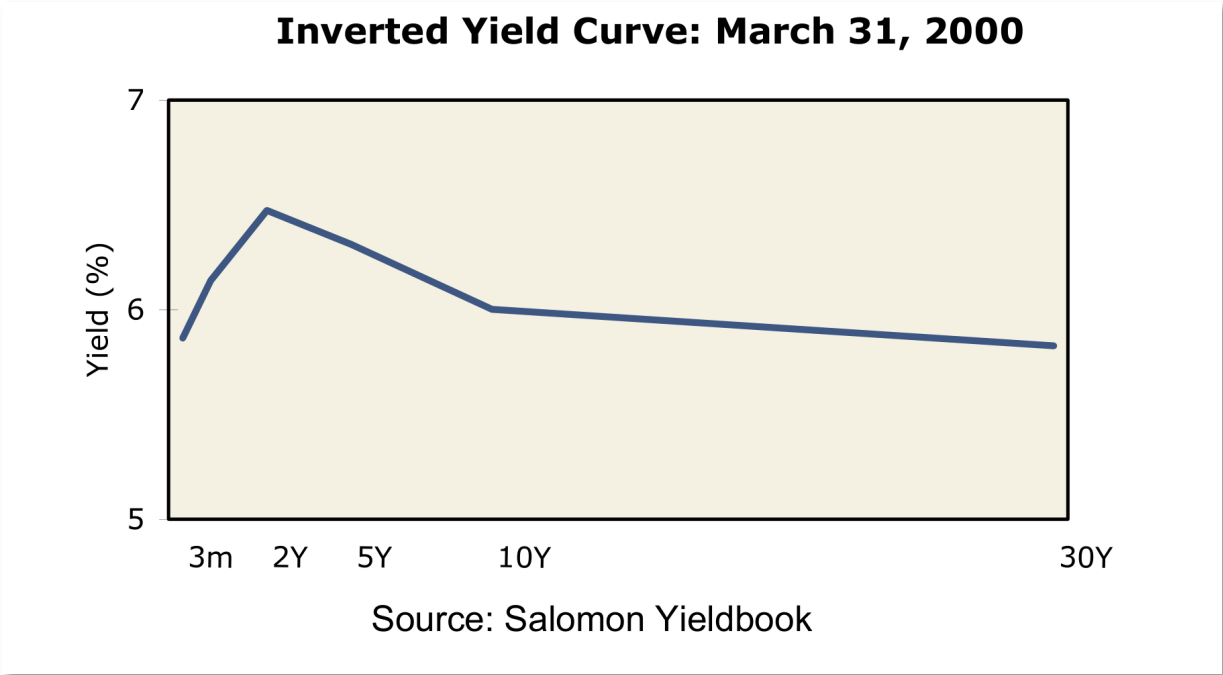
## 10Y-2Y Spread on Treasury Yield, Negative Before Recessions



Source: gurufocus.com

# Historical Evidence of the Inverted Yield Curve

## Yield Curve 1Y Before Dotcom Tech Bubble





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# Action Plans: Understand and Monitor the Spreads

## Key Takeaways

### Monitor Spreads

- Variations: 10Y – 2Y, 18 Months – 3 Months

### Correlation

- Inverted yield curve is not the causation











### Expectations

- Pay attention to economic conditions and monetary policies behind

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# Monitor the Inverted Yield Curve

## Decision Matrix

Decision Criteria	Inverted Yield Curve	No Assessment
Fit with Macro		
Competitive Edge		
Level of Risks		
Implementation Costs		
Profitability		

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