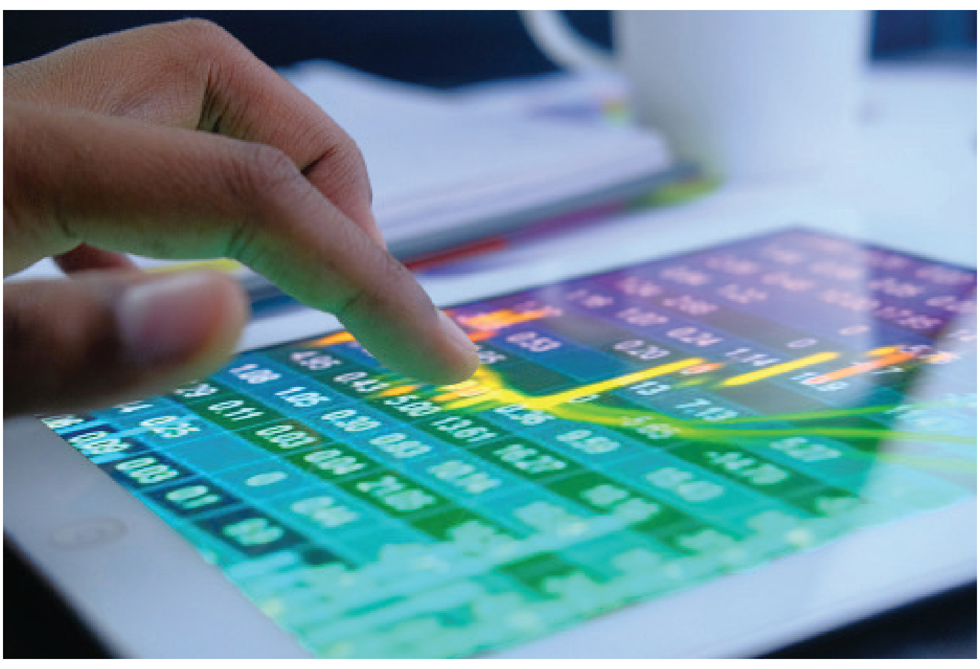
KLINGENSTEIN FIELDS
WEALTH ADVISORS

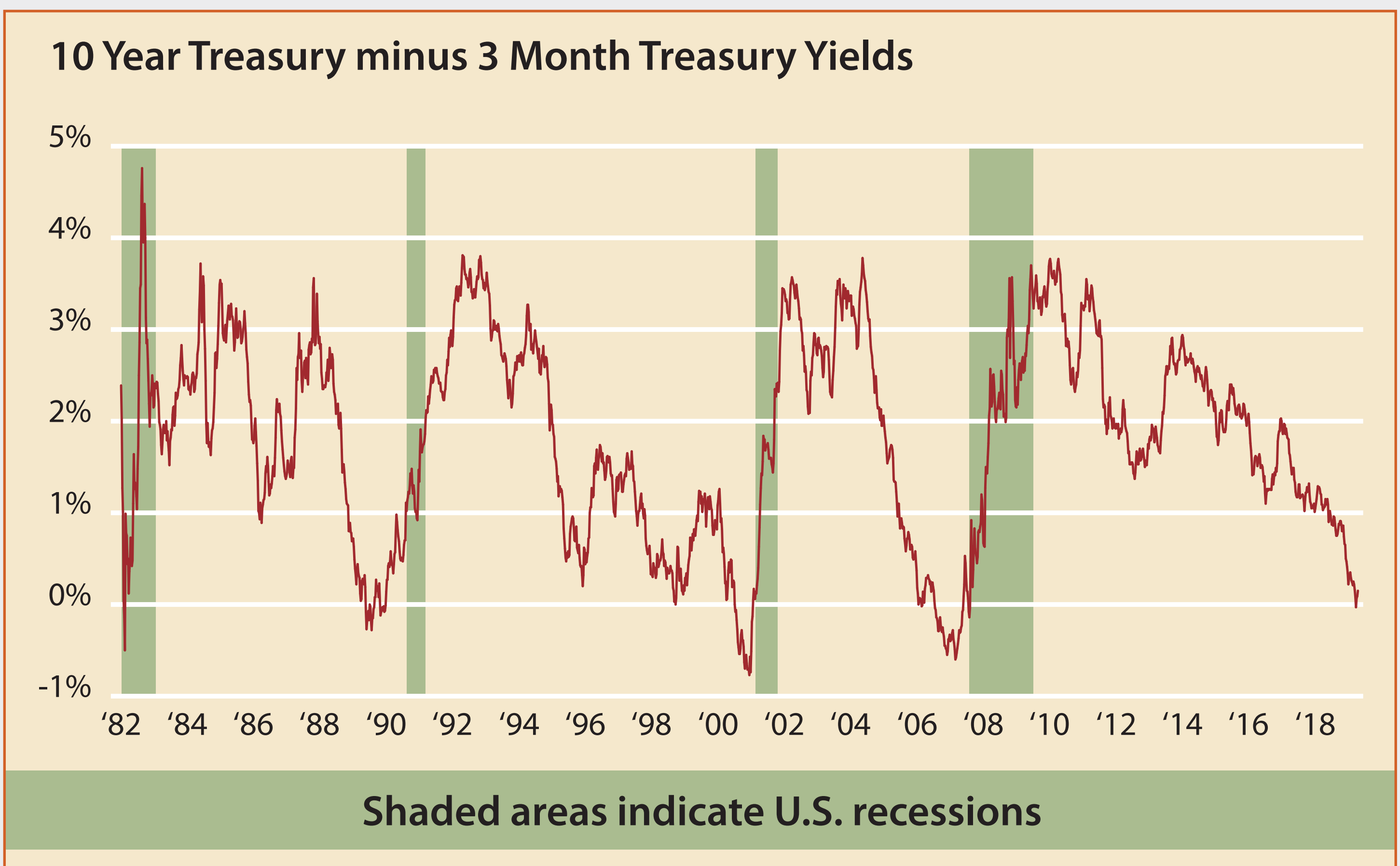
The Shape of Things to Come?



There has been considerable discussion over the past few months regarding the shape of the yield curve, and what it might signify for the economy. The yield curve, which shows yields on U.S. Treasuries at different maturities, is typically upward sloping, because investors in longer-term assets typically demand higher rates, known as a "term premium," as remuneration for tying up their funds for a longer period, specifically to compensate for inflation risks.

Flat, flat, inverted

Recently, however, the curve has flattened, and even temporarily inverted, meaning that yields on longer-term assets are close to, or even lower than, those on shorter-term Treasuries. In the past, views on bond yields have often reflected expectations for future economic growth overall. If investors are worried about slowing future growth and lower rates, they may be more willing to buy longer-term Treasuries to lock in current rates, thus driving down current yields on longer-dated maturities. As demand increases, the Treasury is also able to lower the rates it offers on newly issued long-term Treasury securities. Historically, the last seven recessions have been preceded by a yield curve inversion, leaving many to wonder if a recession is looming on the horizon.



Source: Federal Reserve Bank of St. Louis

Too soon to tell

So far, the yield curve has not inverted for long enough to serve as a strong warning signal, and the inversion was very slight. A flat curve is not as strong a signal that an economic downturn may be ahead. More data points, a more prolonged inversion, and/or a steeper curve would tell a more definitive story.

Other factors at work

There are also other factors that influence term premiums and yield curves, and some of them may be having a greater impact in the current environment than in the past. One in particular is the role that the Fed has taken in the post-financial crisis era in quantitative easing through asset purchases on the secondary market of government and agency securities. Partly as a result of this, the term premium has declined significantly. With that lowered term premium comes a higher likelihood of a flat or inverted yield curve.

Watching carefully

However, yields and yield curves are not the only sign of things to come, and we recognize that the U.S. has experienced an unprecedentedly long period of growth. As always, we are keeping a close eye on the economy, the global situation, and a broad range of other indicators for their potential impact on our client portfolios. As long-term strategic investors, we are focused on growing and preserving wealth for future generations, while also seeking to take advantage of short-term inefficiencies in the market.

We encourage you to contact us at 212.492.7000 with any questions you may have regarding current markets or your portfolio. We believe communication is critical to an enduring relationship. As always, your Klingenstein Fields Wealth Advisors' team is ready to serve you, whatever your needs may be.

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