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## What is the Bond Market Telling Us Right Now?...That Depends...

**Kevin T. Grimes, CFA, CFP® – CEO | Chief  
Investment Officer**

Different corners of the bond market are giving very mixed signals right now. While credit markets are signaling “all clear”, Treasuries are screaming recession warnings.

Credit spreads are the premium paid on borrowing costs for riskier companies. Generally, spreads widen when there are recession worries and contract during rosier times. Right now, BBB rated corporate bonds trade at a 1.88 spread, which is higher than average, but certainly not crisis levels and well off the highs from earlier this year (see Chart 1 below).



**Chart 1: US Corporate BBB/Baa – Treasury 10 Year Spread**

(Source: Bloomberg)

The Treasury yield curve is telling a different story altogether. In normal times bond yields are higher for longer maturity dates to compensate investors for locking in money, much like a 30-year mortgage has a higher rate than a 15-year mortgage for home buyers. Yield curve inversion is when longer dated bonds yield less than short term bonds. It occurs when markets believe that the Fed will have to cut rates in the not-too-distant future, and it is considered a fairly accurate warning sign for recession. Presently the yield curve is at its deepest inversion since the early 1980's (see Chart 2 below).



**Chart 2: U.S. Treasury 2-10 Year Yield Curve**

(Source: Bloomberg)

We think it is unlikely that the Fed will be in a position to cut rates to a stimulative setting in the absence of a recession for fear of stoking inflation again and undoing all the work done in 2022 to contain it, as detailed in “[Soft Landing and Low Rates are not Compatible](#)”. As such, we feel it is likely that the markets will have to adjust with either credit spreads rising (which could be accompanied by some stock market weakness) or longer dated yield expectations adjusting higher.

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