SINTRA
CAPITAL

This Time It's Different?

"This time it's different" … four of the most dangerous words in funds management.

When you lock up your money for a longer period you generally earn a higher rate of interest. Currently this is not the case. Long-term interest rates are below short-term interest rates or technically speaking, the yield curve is inverted. This has occurred 8 times in the last 50 years and each time has been followed by a recession.

In a recent CNBC interview, Campbell Harvey, Finance Professor at Duke University and inventor of the inverted yield curve model (ie. recession predictor) explains why he believes the current signal is false.

He provides the following key reasons:

- Excess demand for labour – There is more job openings than unemployed people, and the gap is large. Unemployment is likely to rise but only marginally. If the economy slows it will still be able to absorb the additional layoffs.
- Consumer well positioned – For example, within the housing sector the amount of equity versus debt is high. Households can generally withstand a decrease in house prices without causing GFC type issues, such as significant negative equity and forced liquidation.
- Strong Financial sector – Banks are well capitalised with elevated provisions and robust earnings. Banks will not add to the problem.
- Psychology – The model effects people's behaviour. Consequently, businesses and consumers are more likely to engage in risk management. They are acting before a recession 'happens', reducing the signal's accuracy. Recessions are more likely to occur when you least expect them.

According to Harvey, a major wildcard is the US Federal Reserve. They were late to the game with the transitory inflation talk. Will they be late again? By not seeing that inflation is under control and continuing to hike rates. Over the last 6 months inflation has fallen considerably. The time to back off is now.

This time might be different.