Today we will focus on yield curve “inversion” (which doesn't seem to be getting that much attention), “inventories” (which I think pose a threat to any ongoing growth for the economy), and finally we explore that it might be “incongruous” to wish for lower oil prices in the near-term. Incongruous might not be the right word, but it was difficult coming up with three “I” words.

**Inversion**

Curves have been flattening/inverting to levels (that are historically important) with less fanfare than I would have expected. Sure, the doomers have latched on to it, but it doesn't seem to be at the forefront of conversations and has garnered minimal media attention relative to where we are.

The 2-year versus 10-year spread is inverted and while the 3-month versus 10-year spread isn't inverted, it has moved dramatically in the past few weeks and has the potential to get there.

The inversion in early 2000 coincided with the bursting of the internet “bubble”. There was a prolonged decline in markets, which to be honest, were also hurt by the attacks on 9/11 and frauds at Enron and WorldCom.

Curves were inverted ahead of the peak in financial markets, but that peak occurred right as some large institutions had to cut dividends and guidance due to their mortgage portfolios. Lots of other factors contributed to the GFC and it didn't really play out for almost another year (stocks rallied back into the fall, then again when Bear Stearns was “saved” in early 2008, only to finally succumb later that year and in the first part of 2009).

The 2019 to 2020 period is tricky. The inversion in the summer of 2019 did precede a sell-off, but there is no way the market was anticipating a COVID shutdown. April 2020 saw inversion, but I think the Fed, the Treasury, and even D.C. realized that they had to act quickly and aggressively. We saw strong initial “emergency” measures followed up by more and more stimulus. Maybe the fact that we avoided prolonged equity market issues in 2020 is why this recent inversion isn't getting much attention (the boy who cried wolf, etc.), but I am not sure that D.C. is prepared to act like they did during COVID or that August 4, 2022
the Fed can be as accommodative (as they are dealing with inflation, at least some of which can be tied to the aggressive responses to the threat of COVID).

I’m not alarmed, but it seems strange that equities have been able to ignore the recent inversion and a 20 bps rise in 10-year yields in less than 48 hours (albeit the 30-year “only” moved 11 bps in that time).

Certainly, inversion occurred before problems really hit markets back in the early 2000’s/pre-GFC and 2020 amounted to a great buying opportunity, but things don’t “feel” quite right to me here.

**Inventories**

I continue to fixate on inventories.

Inventories, in an ideal world, follow a nice pattern. Companies see demand, they build/acquire products, and they then sell those products. Since last summer, inventories have been building month after month. Some of that inventory build can be attributed to getting ahead of supply chain issues (including Just in Case inventories from Just in Time inventories), but some certainly can be blamed on less consumption.
Even with companies wanting more robust inventories, we seem to have moved to a very high cushion.

On the ISM side of things, we’ve had inventory builds contribute to the data for extended periods in the past (like 2018 until early 2019). The peak then was 55 (as opposed to 57.3 recently) and many months were barely above 50 (as opposed to a recent low of almost 52).

**Additional concerns about inventory:**

- Are we done with back orders getting filled? Or, will we see inventories continue to build as orders that were made when lack of inventory due to supply chains seemed like a bigger risk than consumer demand slowing?

- How many products are “99%” completed, just waiting for a missing component? That missing piece could be a ball bearing, or a semiconductor, or some piece of customized plastic, it doesn’t really matter. What matters is if there are a lot of “almost finished” goods that will get converted into finished goods as those missing components arrive, will we have another surge in inventories? Or has that already happened?

I am not only concerned about current levels of inventories, but that we are still on a path (due to prior orders and missing components) that will increase inventories further before they can correct.

**The Incongruity of Wishing for Low Oil Prices**

For the past few months markets, politicians, and the media have been desperate for lower oil prices. All that I can think is, be careful what you wish for.
I use the 6-month forward WTI contract to smooth things out, but typically, as oil goes up, stocks do well (and vice versa). That was the case from 2016 until just recently.

The same pattern holds true for the 2003 to 2011 period, with a couple of short exceptions.

Even from 1999 until 2002 the pattern held up pretty well. This period included 9/11, which many of us lived through and lost friends, and when the U.S. military conducted operations across the globe. Many of my teammates at Academy served in those conflicts and embracing post 9/11 veterans is a huge part of Academy’s Mission (as we pass 100 employees in total, ~49% of them are veterans, many of whom have been wounded in service).

In any case, I’m not sure we should cheer low oil prices.

**Bottom Line**

As discussed in this weekend’s *I Don’t Care, I Love It!* T-report, there is a bull case out there. It is also difficult to fight TINA and FOMO in an illiquid and volatile market, but as Fed speaker after Fed speaker seems intent on hammering home the inflation fight, there is increasingly more to worry about.

**Jobs** are also a concern, but we will know more after Friday’s NFP.
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