The bond market is freaking out. Here’s why that matters

By Paul R. La Monica, CNN Business

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The yield on the benchmark 10-Year US Treasury (https://money.cnn.com/data/bonds/index.html) is now just 2.22% — the lowest level since September 2017. Yields fall as investors buy more bonds, which they typically do during times of economic malaise. It’s a so-called flight to safety.

This current rush into bonds appears to be because investors are fearful of a drawn out trade war between the US and China.

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"Bonds are rallying as a haven asset, dragging the yields lower as investors fret over stalled US — China trade talks. Sentiment is taking a turn for the worse as trade tensions between the two powers show no signs of easing," said Jasper Lawler, head of research at London Capital Group, in a report.
Inverted yield curve is often a sign of bad things to come

The yield on the 3-month US bond is currently higher than the 10-year, hovering around 2.35%. That’s another cause for concern. When short-term rates are higher than long-term yields, that is called an inverted yield curve.

That typically happens before a recession.

"When the yield curve inverts, it’s not the time to borrow money to take a vacation to Orlando. It is the time to save, to build a cushion," said Campbell Harvey, a finance professor at Duke University and partner and senior advisor at investing firm Research Affiliates, in a video interview [https://www.researchaffiliates.com/en_us/insights/conversations/the-inverted-yield-curve.html?evar36=eml_ra-conversations-the-inverted-yield-curve_secondary_a_img&cldee=cGF1bC5sYW1vbmU1rS80bXJiO2l0eQ==&recipientId=contact-57ebafdec7cbe2119aa7005056b3c3cff-947317135079486aaa62fedc75e5fe9&esid=5d607d96-8f81-e91e-90db-005056bc1247] for Research Affiliates.

The yield curve inverted once before this year, in March. But before that, the yield curve hadn’t flipped since 2007 — just before the start of the Great Recession.

Should investors be worried about another dramatic downturn like that one? Not just yet.

For one, American consumers are still spending. Leading retailers like Amazon, Walmart and Target have done well despite the threat of higher prices on some goods because of tariffs. Consumer confidence also remains high.

The United States and China could reach a trade deal and forestall a global panic. And odds are now increasing that the Federal Reserve will save the day by lowering rates later this year.

Yields sliding in rest of the world

But bond yields around the globe are falling too, which suggests investors remain concerned that the impact of a US-China trade war will have wide implications.

10-Year bond yields in Germany, Switzerland and Japan are currently in negative territory while rates in France, Spain and the United Kingdom are below 1%.

The weakness in Europe in particular could be a bad sign since the European Union is a big trading partner for both the United States and China.

Another cause for concern: The US dollar has rallied lately as Treasury yields have fallen. That’s a potential problem for the global economy, because a stronger dollar makes US goods more expensive overseas.

Unless bond yields start to climb again and the dollar loses some of its strength, investors may remain worried about a global slowdown.

"For stocks to continue to rally we need to see higher Treasury yields driven by hopes for better growth, and a weaker dollar driven by improved economic prospects in Europe," said Tom Essaye, editor of The Sevens Report, a daily markets newsletter.
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