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## The Economy May Not Slip Back into Recession – There May be Some Silver Linings in These Clouds.

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In recent months there has been abundant press coverage about how the U.S. is on the verge of another recession. Yesterday, however, Paul J. Lim wrote an interesting column in the business section of the New York Times. Lim is a senior editor at Money magazine and one of my favorite market observers.

Lim points out that even though the S&P 500 is basically flat for the last 9 months and interest rates on Treasury bonds and notes are at historic lows, there may be some silver linings in these clouds. For example, transportation stocks are often considered a reliable indicator of an improving economy, and the Dow Jones transportation index is up 8% so far this year; that's 4 times the gain of the overall Dow Industrial index. David Winters, manager of Wintergreen Advisers, uses rail traffic and other forms of transportation as a "canary in the coal mine" to predict economic gains. Economist Edward Yardeni, president of Yardeni Research, says that a tool he uses to gauge the health of the economy is a 26-week moving average of rail-car loads. That index recently hit a 19 month high. Such a high would seem to indicate that a double-dip recession is a low probability.

An indicator of market health and investor confidence in the economy is something called the VIX, which is the Chicago Board Options Exchange Volatility Index. In the worst of the global financial crisis in 2008, the VIX skyrocketed up above 80. But recently, the gauge has plummeted to 22, which is right above its historical average of 20. If investors were truly jittery about an impending recession or market downturn, the VIX would certainly be much higher.

Looking under the surface of the bond market also seems to indicate the possibility of a more optimistic outcome. Normally during an investor panic, yield

spreads widen significantly as the rush to safe Treasuries occurs. Yield spreads are the differences between the yield on risk-free Treasuries and the yields on other types of bonds. For example, the yield spread between investment-grade corporate bonds and treasuries is now just 1.9%, compared to late 2008 when it was more than 6%. The Spread between high-yield (or junk) bonds and Treasuries has narrowed sharply as well, from 18% in 2008 to the current spread of less than 7%.

Finally, another indicator called the TED spread seems to indicate that volatility and anxiety in the credit markets have subsided considerably. The TED spread is the difference between LIBOR, which is a rate that banks charge each other for lending, and short-term Treasuries. At the worst of the global credit crisis, the TED spread shot up to 4.6%, indicating a real unwillingness of banks to lend, even to each other. Today the TED spread is way down at 0.145%. In late May, when there was a lot of concern about Europe's health, the TED spread was at 0.38%, which is still relatively low.

So does it matter if we dodge the "double dip recession" bullet? A recent study looked at how the market performed when the economy seemed to be verging on recession. Whenever there were near misses, as Paul Lim's article indicates is likely now, U.S. stocks subsequently gained more than 15% in the period of September through January that followed the near misses.

I'm not suggesting that the recovery will be robust, however, especially since the unemployment picture continues to look bad. But it sure tells me that there are fewer reasons to be pessimistic than before I read the Lim article.