



Does the Yield Curve Inversion Truly Signal a Recession Is Imminent?

Description

Last week investors saw a signal that some analysts believe portends that a U.S. [recession is imminent](#); this was the yield curve inverting for the first time since 2007. That event is essentially where the yield on short-term bonds exceeds that on longer term instruments, signalling that investors are concerned by the longer-term outlook boding poorly for high growth stocks such as **Dollarama Inc.**

Will a recession occur?

The reason this sparked considerable fear among financial markets is that almost every major U.S. recession has been preceded by an inverted yield curve, making it an accurate historic sign that an economic downturn is looming. This indicates that a recession could be due because typically the future value of money is greater than in the present.

That means if the yield on two, three- or five-year bonds is lower than for short-term instruments which mature in up to a year later, then markets are anticipating that the economy will decline.

Nonetheless, it appears that markets have overplayed the fear card and that a recession could still be a long way off. While considerable economic uncertainty still exists, there are signs that the U.S. economy is still firing on all cylinders, which is aided by the Fed's dovish approach to monetary policy.

Signs that the U.S. and China have reached an agreement on trade, thereby averting a damaging trade war, upbeat manufacturing data and better-than-expected demand for energy all point to the global economy performing more strongly than anticipated. It is also anticipated that Beijing will engage in further economic stimulus if growth in China doesn't meet its projections.

Those factors also bode well for commodities including base metals, oil and natural gas, which in turn will support the economies of many emerging nations that are dependent on the extraction and export of commodities as drivers of GDP growth.

For these reasons, the reaction of financial markets to the yield curve inversion appears heavily overbaked given that the yield on 10-year treasuries rose sharply only a week after the event.

How to hedge against a downturn

In such mixed circumstances, the best stock to hedge against the risk of an economic downturn while still being able to benefit from stronger global growth is **Brookfield Infrastructure Partners L.P.** ([TSX:BIP.UN](#))([NYSE:BIP](#)). The partnership's globally diversified portfolio of assets critical to modern economic activity possess considerable utility like defensive characteristics.

These include a wide economic moat, 95% of its earnings coming from contracted or regulated sources, operating in oligopolistic markets, allowing Brookfield Infrastructure to act as a price maker and inelastic demand for the utilization of those assets. Those attributes virtually guarantee Brookfield Infrastructure's earnings and protect it from economic slumps.

Because the partnership's assets such as data centres, ports, railroads and toll roads are crucial to economic activity, any improvement in the [global outlook](#) will boost demand for their utilization, leading to higher earnings.

That ability to grow earnings at a solid clip is enhanced by Brookfield Infrastructure's considerable direct as well as indirect exposure to emerging economies including Colombia, Brazil, Peru, India and China.

The economic performance of those developing nations is less correlated to developed markets such as the U.S. and Canada reducing the impact of a recession in North America on Brookfield Infrastructure.

As a result of these characteristics, the partnership's EBITDA has grown at a healthy clip. Between 2013 and 2018, Brookfield Infrastructure reported a compound annual growth rate (CAGR) for EBITDA of 7% with a steadily growing proportion coming from energy and transportation infrastructure.

Why buy Brookfield Infrastructure?

Those attributes along with a proven history of recycling capital by making opportunistic acquisitions and investing in organic growth makes it likely that Brookfield Infrastructure can deliver the 12% to 15% annual total return promised.

For these reasons, the partnership is the ideal stock to hold in circumstances in which it is particularly difficult to predict the direction of the global economy. While investors wait for the economic outlook to improve, they will be rewarded by Brookfield Infrastructure's sustainable and regular distribution yielding a juicy 5%.

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