

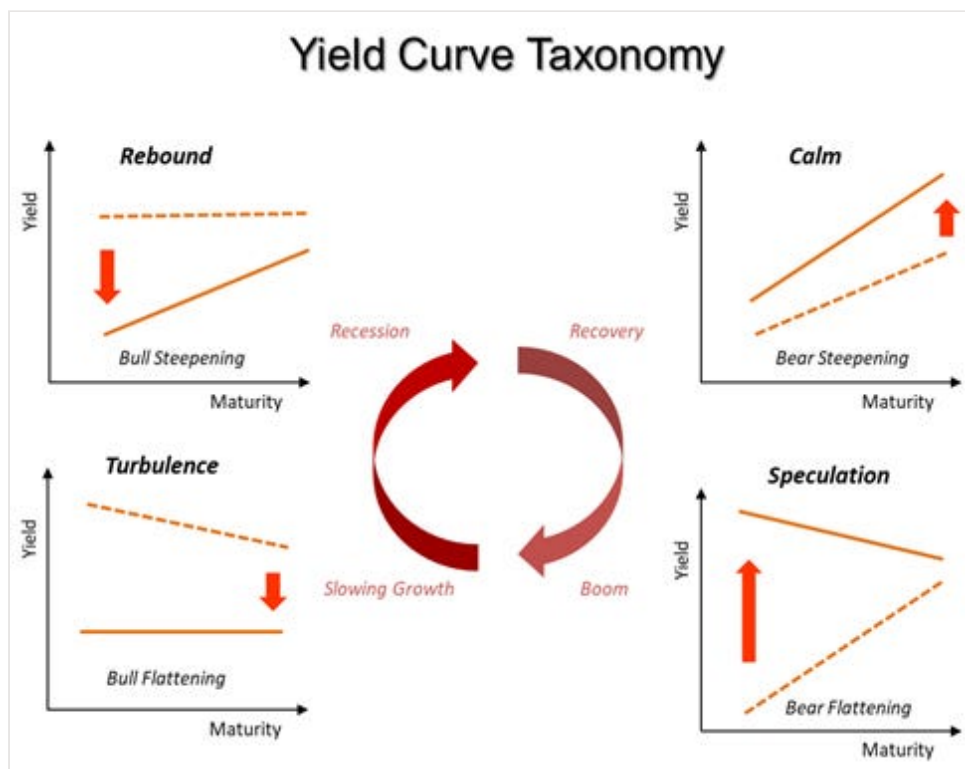
Will 2027 Prove a Recession Year?

The Investment Clock Is Ticking

Markets move in cycles, but they are also forward discounting mechanisms. Investors typically look six to twelve months ahead. The crucial question therefore is not what the World economy looks like today, but what it is likely to look like in the second half of 2027.

Viewed through the lens of the Investment Clock, we remain in a relatively standard fixed-income cycle. The early-cycle bull (yield curve) steepener that characterized the Rebound investment phase has given way to the bear flattener associated with the late-cycle Speculation regime. If the cycle continues to evolve sequentially, as expected, the next phase should be a bullish flattener, with long yields falling, as the clock advances into Turbulence.

Subscribed



These investment regimes correspond closely to the four phases of the Global Liquidity Cycle (economic cycle): Rebound (Economic Recession), Calm (Recovery), Speculation (Boom), and Turbulence (Slowdown). Today's combination of robust economic growth, firm inflation pressures, and speculative market behaviour is entirely consistent with the bear-flattening yield curves that have dominated 2026. Although recent weeks have seen a temporary bear steepening, we view this as a short-term interruption rather than a change in trend.

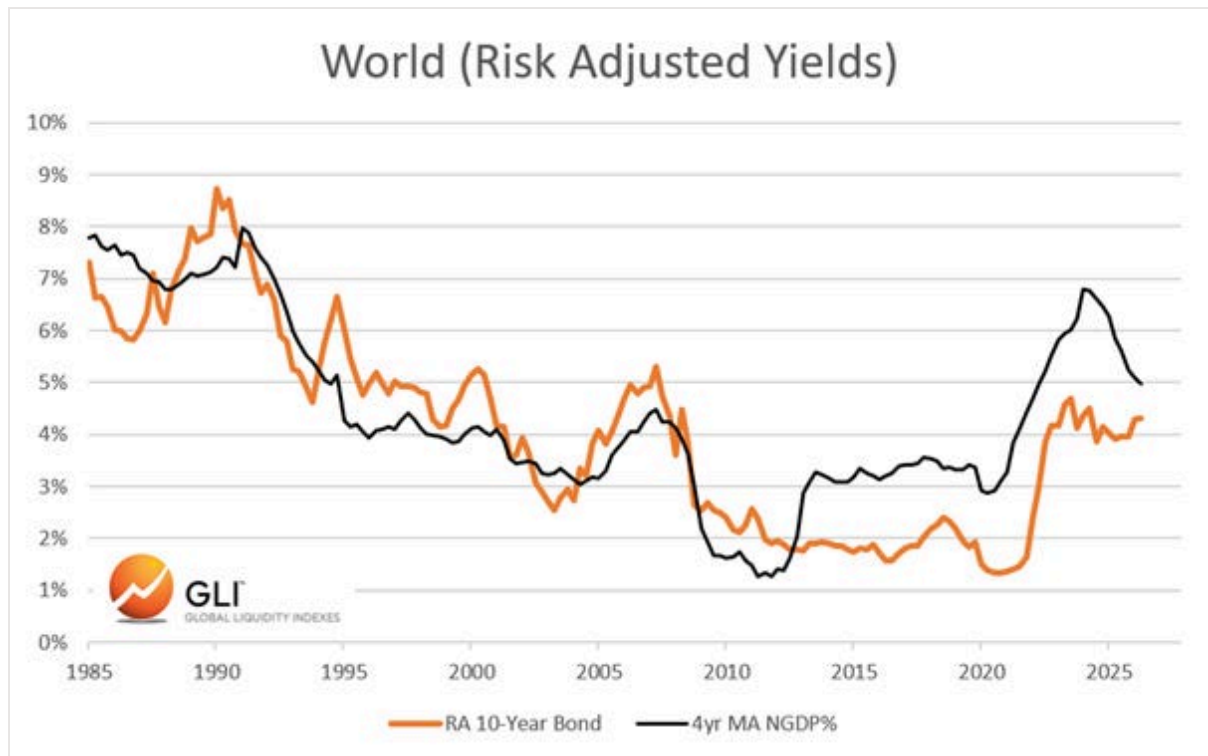
Main Points

- **2026 has been driven by a powerful acceleration in World nominal GDP growth**, explaining both higher bond yields and stronger earnings. Rising yields have reflected stronger growth rather than primarily fiscal concerns
- **The Investment Clock appears to be moving from the late-cycle “Speculation” phase toward “Turbulence”**. The current bear-flattening environment is typical of a boom phase, but the next stage should be characterised by slowing growth and a bullish flattening of yield curves
- **The main threats to continued economic expansion are rising bond volatility (MOVE) and higher energy prices**. Both indicators have deteriorated meaningfully and historically have preceded economic slowdowns by tightening financial conditions and squeezing profit margins
- **The evidence points to a slowdown rather than an outright recession**. Oil prices and bond volatility are warning of weaker growth ahead, but neither has yet reached the extreme levels normally associated with recessionary conditions

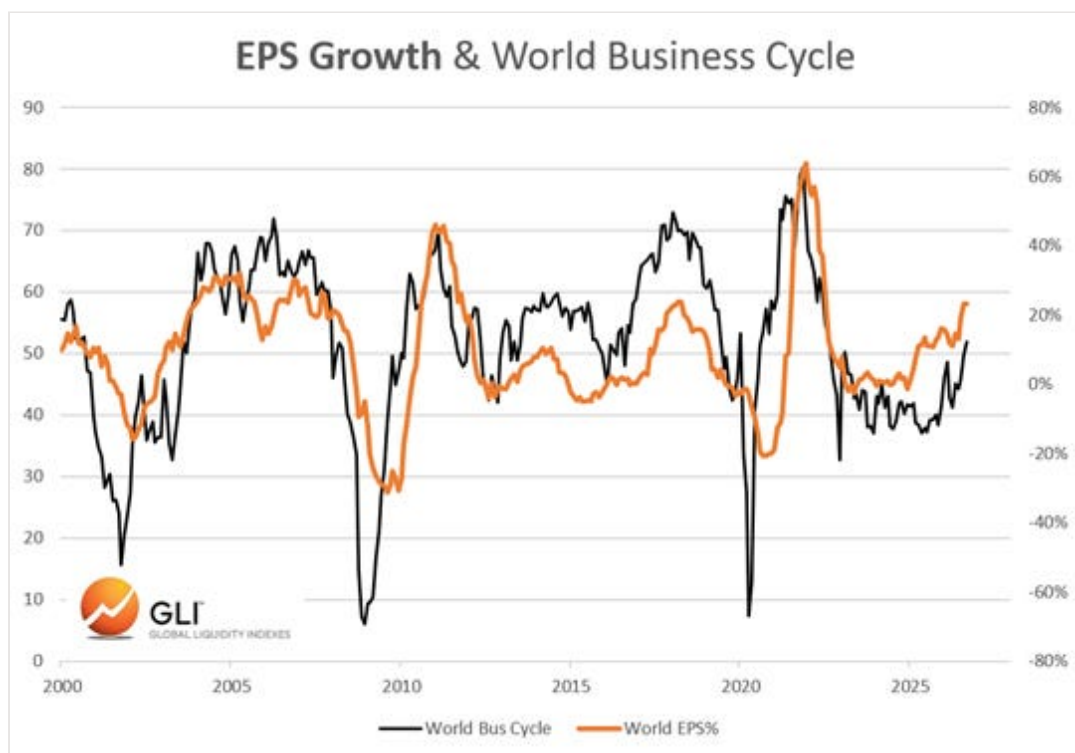
Strong Economies Often Have Weak Financial Markets

Indeed, 2026 has been primarily a story of accelerating nominal growth. Bond markets have struggled not because of fiscal deficits, but because stronger NGDP growth has required higher interest rates. Fiscal concerns matter, but they have been secondary to the powerful cyclical upswing in economic momentum.

The relationship is evident in the chart below, which compares a four-year moving average of World NGDP growth with bond yields adjusted for term premia. These adjusted yields effectively capture the market's expectation of average policy rates across the maturity of the bond.

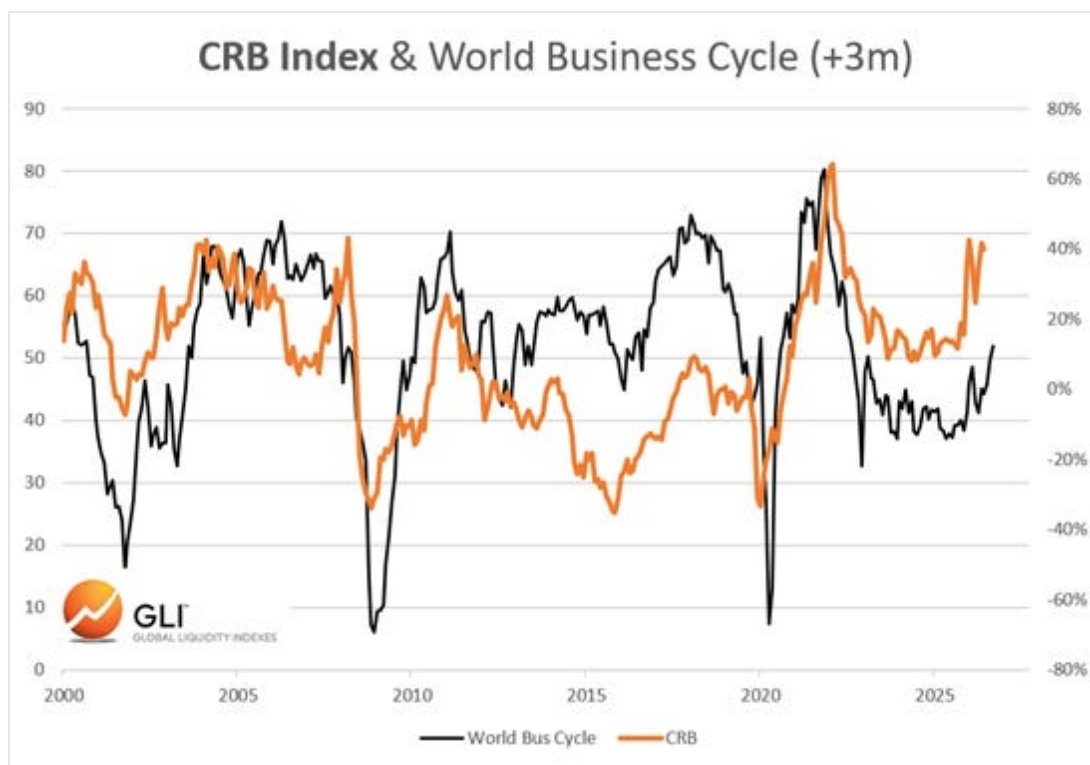


World NGDP growth is now running roughly two percentage points above the levels recorded in the early 2000s. That shift alone can explain much of the increase in bond yields toward 4%. Moreover, World nominal GDP growth (NGDP) is now expanding at its fastest pace since the early 1990s, a period when bond yields averaged between 6% and 7%. However, the absolute size of the debt stock is a multiple bigger, implying that the interest burden will weigh heavily on the economy.



The implications have been visible across markets. Stronger nominal growth has fuelled a resurgence in corporate earnings and ignited commodity markets. While rising bond yields have constrained equity

valuations, commodities have been the clear beneficiaries of the reflationary environment. Avoiding bonds has been the correct strategic decision, and commodity exposure has proven even more rewarding than equity ownership. Evidence the co-movement between World commodity prices (CRB Index) and the business cycle, below:



Business Cycle Risks

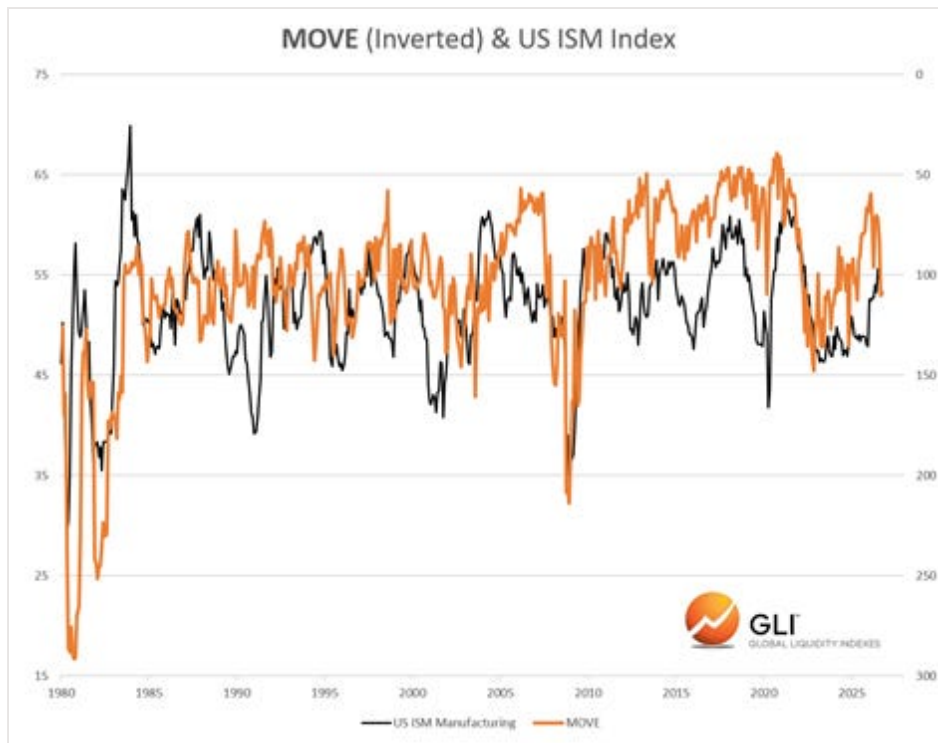
The key question now is what comes next?

Economic expansions rarely die of old age. They are usually brought undone by tightening financial conditions and rising input costs. Rather than focus on inflation itself, we prefer to monitor two leading indicators: bond market volatility and energy prices.

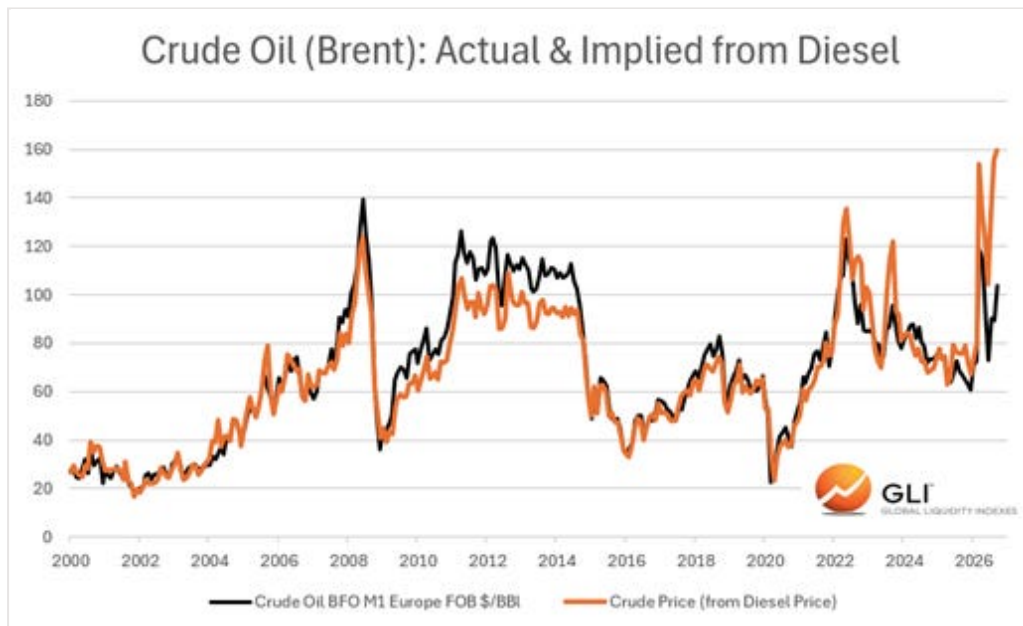
Bond volatility, captured by the MOVE Index, acts as a barometer of financial stress. More importantly, it influences liquidity creation throughout the financial system. **A higher MOVE Index reduces dealers' willingness to intermediate risk, lowers collateral velocity, and weakens the liquidity transmission mechanism that supports growth and asset prices.**

Energy prices work through a different channel. Rising oil prices squeeze corporate profit margins and drain household purchasing power before eventually feeding through into inflation.

The charts below show the historical relationships between the MOVE Index and US economic activity, as measured by the ISM survey, together with implied oil prices derived from the recent surge in diesel markets.



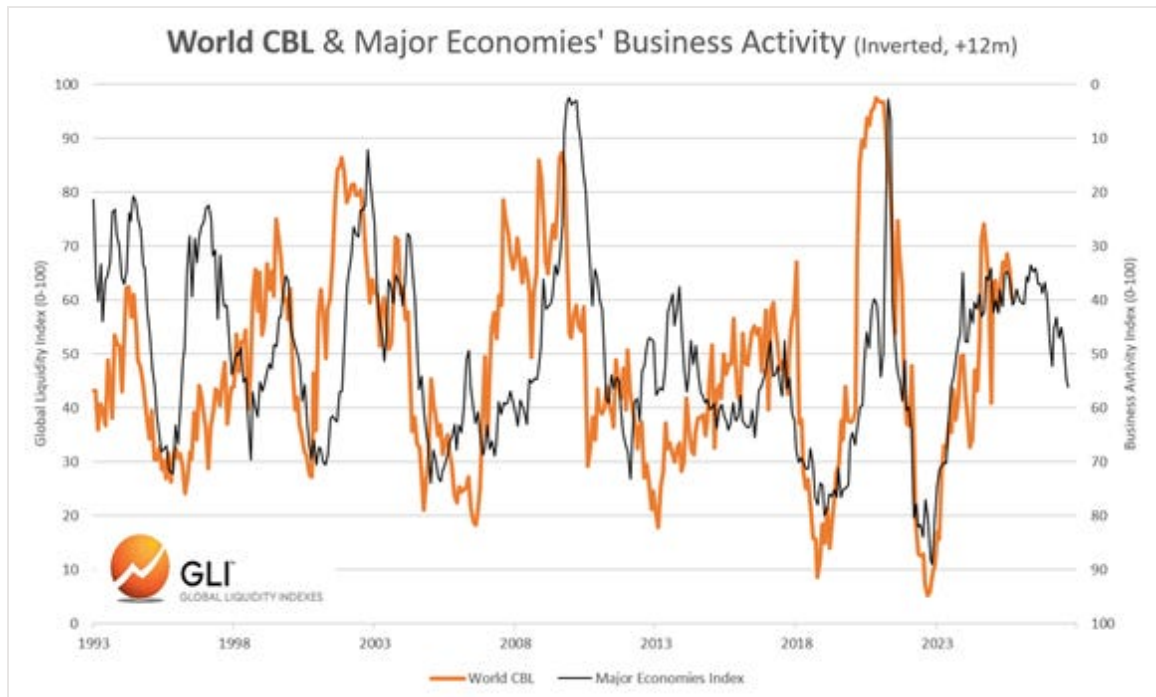
Historically, major increases in oil prices have been associated with sharp economic slowdowns and, on occasion, outright recessions. Current diesel prices imply an equivalent crude oil price of more than US\$160 per barrel. While that level may not yet be sufficient to trigger recession, it is certainly consistent with a meaningful deceleration in real economic growth.



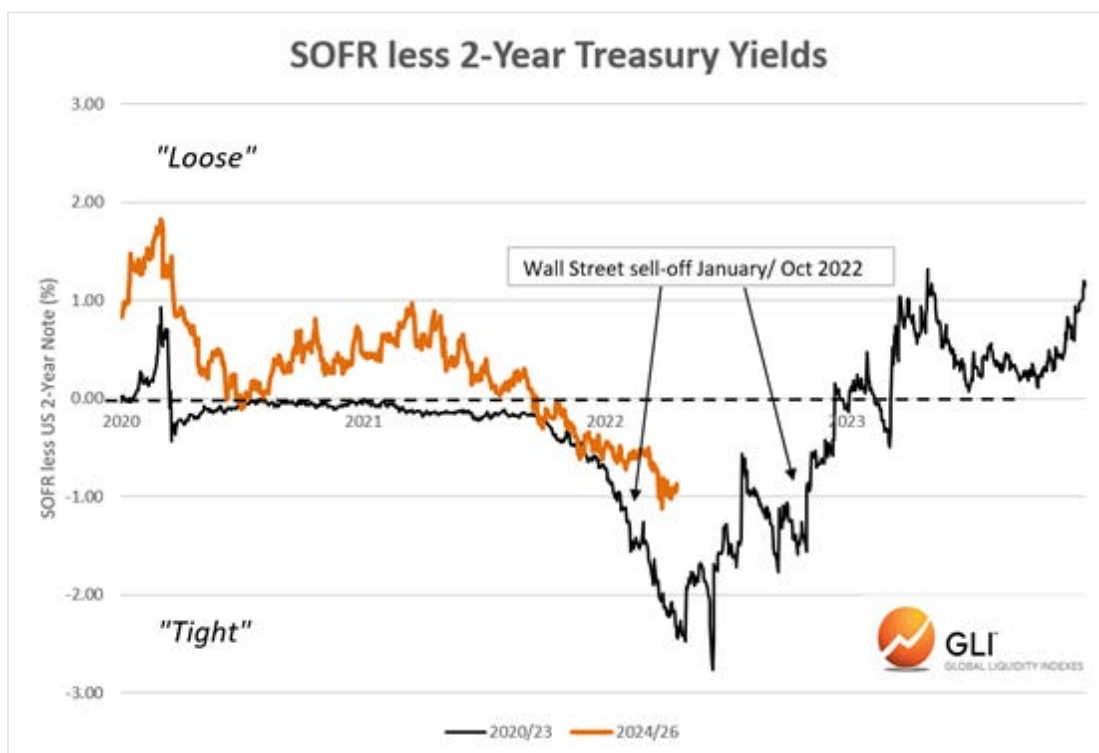
The MOVE Index sends a similar message. Recent readings have decisively broken above 100, signalling increasing stress in financial markets. Historically, however, recessions have tended to occur only when MOVE rises beyond approximately 135.

To add context, alongside the US Fed (and other Central Banks) are tightening. The following chart shows our index of World Central Bank Liquidity and the World business cycle, inverted and advanced by 12 months. In

other words, strong growth today implies tighter policy liquidity over the next 12 months.



The caveat is that the pace of tightening, at least in the US, is unlikely to match the sharp squeeze engineered under the Powell Fed. We have argued before that in a World of 'Capital Wars' and geopolitical tensions, policy makers are more likely to tolerate inflation and less prepared to risk triggering recessions. Evidence the following chart, which plots daily data on the US 2-year Treasury less SOFR spread for the current period compared to the 2021-22 tightening. **It seems that the Warsh Fed is tightening, but at half-pace.**



Taken together, these indicators, together with the on-going impetus from persistently large Federal deficits, suggest that recession is not yet the most likely outcome. The more probable scenario is a significant slowdown in global NGDP growth during the next six to twelve months. In short, we may shift from a 'K'-shaped economy to a backward 'J' shaped one.

Investment Conclusions

For investors, that distinction matters. Markets do not need recession to reprice. A transition from boom to slowdown would be sufficient to move the Investment Clock into the Turbulence phase, triggering a rally in government bonds, a moderation in commodity performance, and a shift in market leadership away from the sectors that have dominated 2026.

• Re-enter Bond Markets

The biggest investment implication is likely a turn in the bond cycle. Increase duration exposure and prepare for a meaningful bond rally over the next 6-12 months

- Bond markets have already absorbed much of the NGDP acceleration.
- If growth slows through 2027, policy-rate expectations should fall.
- Yield curves should bullishly flatten as investors price weaker growth

• Reduce Commodity Exposure

Commodity strength has been one of the best expressions of the 2026 boom. However, if the cycle moves into Turbulence, commodity performance should moderate. Take profits in commodities and move from overweight to neutral.

- Strong NGDP growth.
- Strong earnings.
- Tight physical markets.

• Become More Selective in Equities

An economic slowdown is not necessarily bearish for equities, but leadership will change. Rotate away from highly cyclical exposures and toward defensive sectors that benefit from lower yields and slower economic growth.

- Cyclical sectors tend to lose momentum.
- Valuation support improves as bond yields peak.
- More defensive and quality growth sectors generally outperform.

- **Expect Falling Liquidity Beta**

The underlying message is that a rising MOVE index is not simply a bond volatility story, but a further warning about tightening Global Liquidity. Hence, favour assets with improving cash-flow visibility and less dependence on near-term liquidity drivers.

- Higher MOVE reduces collateral velocity.
- Lower collateral velocity constrains liquidity creation.
- Slower liquidity growth ultimately weighs on asset returns.

The investment clock is ticking. The evidence increasingly suggests that by mid-2027 the issue will not be how strong growth remains, but how quickly it is slowing.

The most likely 2027 outcome is not recession but a transition from boom to economic slowdown, implying lower bond yields, stronger bond returns, weakening commodity momentum, and a leadership shift within equity markets.