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Market Insights

"The yield curve does not cause a recession in my framework. The yield curve is just an elegant way to summarize sentiment in the economy."

–Campbell R. Harvey, Ph.D., Professor of Finance, Duke University (July 1, 2019)

AN UNRELIABLY RELIABLE INDICATOR?

In 1982, a leading Canadian mining company hired a summer intern named Campbell Harvey, a first-year MBA student from York University in Toronto. As the junior member of the corporate development team, Harvey was handed a deceptively simple task: come up with a forecast of the U.S. Gross Domestic Product (GDP) (see Chart 1).

Never mind that economic forecasting firms charged $250,000 or more for such analysis, employing teams of PhDs with access to vast computing resources. Luckily for Harvey, no one had bothered to explain that the job was essentially impossible, so he went at it with a vengeance and stumbled on what seemed like an important pattern: when short-term interest rates exceeded long-term rates, known as a yield curve inversion, economic slowdowns apparently followed. Incredibly, the mining company could essentially replace those quarter-million-dollar forecasts of GDP growth for 25 cents: the price of *The Wall Street Journal*.

Unfortunately, Harvey's and his employer's luck both ran out at the same time. The recession of early 1980 was followed by a recurrent and persistent bout of inflation, which prompted Federal Reserve Chair Paul Volcker to raise rates to about 20% for a second time, contributing to a longer and deeper recession from July 1981 to November 1982 (see Chart 2).

Already a year into it and with no end in sight, the mining company made the fiscally prudent cost-cutting decision to terminate its entire corporate development group, including Harvey, before the summer intern ever got to present his findings.

Harvey's insight might have otherwise gone unnoticed, but for his poor employment prospects. Instead of wading into a shaky job market, he matriculated in the PhD program of the University of Chicago Graduate School of Business (now the Booth School of Business), where he developed his yield curve ideas further studying under Gene Fama, who later won the Nobel Prize in Economic Sciences (2013) for empirical analysis of asset prices.

His 1986 doctoral dissertation was widely circulated in academic circles, and a few years later, economists at the Federal Reserve took notice when Harvey's prediction of a recession in 1990–1991 proved correct. Since then, and for the past four decades as a professor of finance at Duke University, Harvey has gained in stature as his recession indicator went 8 for 8, and his 'inverted yield curve equals recession' concept became accepted as financial law. That is, up until now.

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WHAT THE CURVE SAYS NOW

According to Harvey's analysis, the U.S. economy goes into recession between 6 and 23 months from the time of the first inversion. In early July 2022, the yield on the 10-year Treasury fell below the 2-year Treasury, and the inversion lasted for a historic 24+ months until late August 2024. For the past 14 months, the curve has been modestly positive (using the widely watched 2s/10s measure; Harvey's research focused on the 10-year/3-month spread; see Chart 3). As of October 2025, no National Bureau of Economic Research (NBER)-dated recession has followed the most recent inversion; if that persists, it would be the first time this indicator has failed.

Instead of taking satisfaction in seeing that the economy dodged a bullet, forecasters have kept busy coming up with explanations for why the 2022-2024 inverted yield curve didn't work, might work, or actually did work. For starters, some suggest that it didn't work this time because the inverted yield curve was so well studied and reported on. In that sense, it's a bit like a quantum electron: we know it's there, but the moment you go to look at it, it disappears. Another theory is that the model is actually correct, but the timing needs adjustment. The model predicted a recession with a lead time of between 6 months and 23 months, but that was based on a small number of data points. The lead time could be longer than 23 months, which means that we're not out of the woods yet. Or maybe the GDP numbers themselves are not as reliable indicators as they once were. If that's the case, there's a possibility that we actually are in a recession, and the model is indeed 9 for 9.

Another theory, put forward by Harvey himself, is that inverted yield curves now *prevent* recessions, a reversal of his previous ideas. On a 2024 CFA podcast, he stated, "The yield curve has changed its role since I published my dissertation. It used to just reflect expectations of economic growth, and now it's more causal." By his new reckoning, companies see inversions and preemptively cut costs, potentially creating a self-fulfilling prophecy or, paradoxically, softening a predicted recession. The model is a sort of tsunami warning, or at least, that explains what happened between 2022 and 2024.

Perhaps instead of keeping a scorecard of inverted yield curves, analyses might be more useful if we step back and consider some broader implications, as the New York Fed suggests: "Although yield curve inversions may not be followed by recessions as a matter of universal mathematical principle, they should definitely raise warning flags about future output growth." Whether or not they are perfect predictors, it's fair to say that yield curves significantly outperform other recession indicators.

So, in any case, even if they aren't reliably predictive, they do seem to be reliably useful.

Charts

Chart 1: Real Gross Domestic Product - Percent Change from Preceding Period (April 1, 1947 - April 1, 2025)

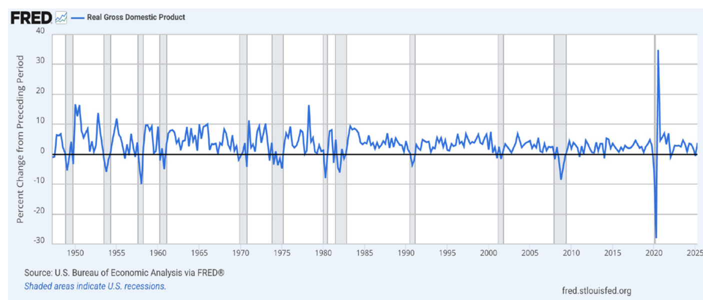
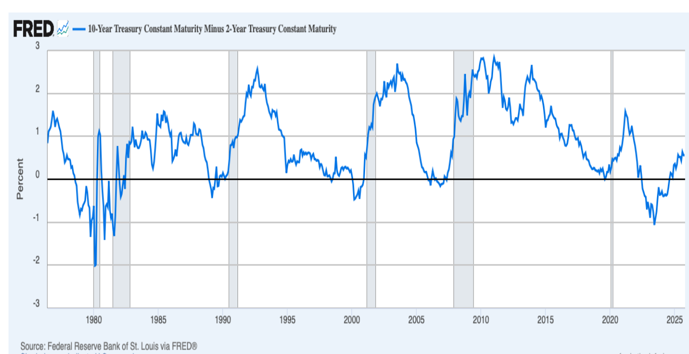
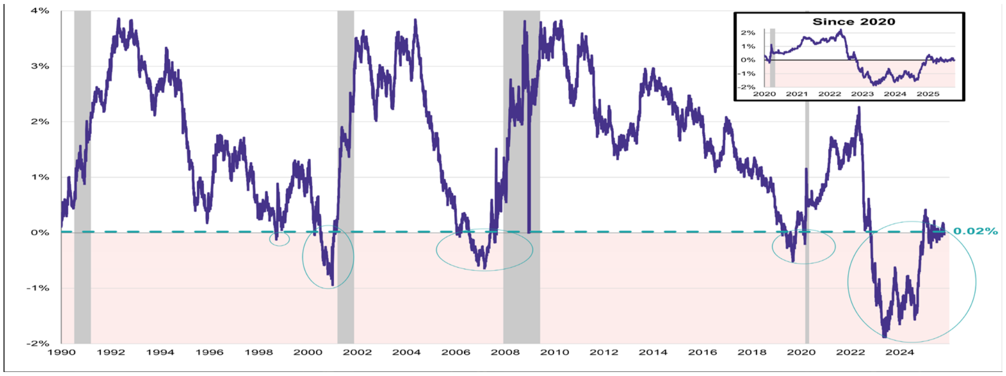


Chart 2: 10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity (June 1, 1976 - October 17, 2025)



How to Read this Chart: *When the blue line drops below zero (the black horizontal line), short-term interest rates exceed long-term rates, and the yield curve is 'inverted.' Cases of such inversions have preceded every recession (shown in gray bars) since 1980. The deeper the line goes below zero, the more severe the inversion.*

Chart 3: 10-Year Treasury Constant Maturity Minus 3-Month Treasury Bill (January 1990 - October 17, 2025)



How to Read this Chart: *This shows Campbell Harvey's original yield curve indicator—the spread between 10-year Treasury bonds and 3-month Treasury bills. Harvey chose the 3-month rate to match GDP's quarterly reporting frequency. When the line drops below zero (into the pink shaded area), the yield curve is inverted. The blue circles highlight inversion periods that preceded recessions (gray bars). The deeper below zero, the more severe the inversion. The 2022-2024 inversion reached -1.8%, the deepest since the early 1980s. The inset shows the recent inversion in detail, lasting from October 2022 through July 2024.*

Click each chart for its original and enlarged data source.

This newsletter was written by Mariner. Approved for advisor use and for use with the retail public.

Chart 1 Source: fred.stlouisfed.org, Updated September 25, 2025

Chart 2 Source: fred.stlouisfed.org, Updated October 17, 2025

Chart 3 Source: advisorperspectives.com, October 17, 2025

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No strategy assures success or protects against a loss. Diversification and asset allocation strategies do not guarantee profits or protection against loss. Investments in securities and other instruments involve risk and will not always be profitable. Loss of principal is possible.

References to the "yield curve" in this newsletter refer to U.S. Treasury yield spreads, including the 10-year minus 2-year and the 10-year minus 3-month measures. U.S. Treasury securities are backed by the U.S. government as to the timely payment of principal and interest; if sold prior to maturity, their market value will fluctuate with interest rates.

Recession dating, where referenced, follows the National Bureau of Economic Research (NBER) Business Cycle Dating Committee. Data sources for the charts include the Federal Reserve Bank of St. Louis (FRED) and the Federal Reserve Bank of New York; update dates are shown on each chart. Information is believed to be reliable but is not guaranteed.

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