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Asset Management

Yield Curve

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In recent months, there has been increased market commentary regarding inversion of the yield curve – in other words, when short-term interest rates exceed long-term interest rates.

Investors have likely heard many times that an inverted yield curve might indicate an upcoming recession, and given that recessions are typically bad environments for equities, this has the potential to increase risk aversion.

The devil is often in the details, however. As there are many different points along the yield curve that can be inverted, it's important to ask "Which points are important to focus on?" For example, should we be concerned if the 2-year yield is higher than the 10-year yield? Or should we compare the 3-month yield with the 30-year yield? What does it mean if the curve inverts briefly one day and then steepens the next? Further, does the inversion need to be persistent to predict an actual recession?

In the mid-1980s, Campbell Harvey, a Duke University finance professor, performed pioneering research which showed the predictive power of the yield curve. Here is a link to a recent interview with Campbell Harvey – this piece offers a fascinating look at the yield curve today, as seen through the lens of Harvey's 1986 pioneering work on yield-curve inversions: https://www.researchaffiliates.com/en_us/insights/conversations/flattening-yield-curve.html

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