Duke University professor Campbell Harvey pioneered the inverted yield curve, which has been a reliable recession indicator in the past. Now, he's advising investors to take preventative action now rather than wait for a recession to be in full swing.

"This is the time where you need to reflect upon your strategy. It's actually easy to manage assets when the economy is booming. It's much more difficult to manage into a turning point," said Harvey. "It's way better to have a plan to go by than to find yourself in a situation where the recession hits and you have to improvise."

Harvey's research found that since 1950, an inverted yield curve between the 3- and 10-month curves have reliably forecasted a recession on seven different occasions. Based on Harvey's research, the yield curve must be in inversion mode for at least three months before sounding the alarm on a recession.

However, that time is now to sound the alarm.

"It’s not normal. It’s something that foreshadows bad times," said Harvey.
Harvey’s comments come after the first day of October gave investors news they might not want to hear, but serves as a warning that a rotation to defensive sectors could be the best move. U.S. manufacturing Purchasing Managers’ Index from the Institute for Supply Management showed 47.8% during the month of September, which is the lowest since June 2009. Furthermore, September follows another contraction the previous month.

Analysts are primarily citing the U.S.-China trade deal as the main culprit.

“We have now tariffed our way into a manufacturing recession in the U.S. and globally,” said Peter Boockvar, chief investment officer at Bleakley Advisory Group.

One way to take heed of a forthcoming slowdown is to focus on relative value exchange-traded funds (ETFs) that emphasize defensive equities over cyclical equities. In particular, the Direxion MSCI Defensives Over Cyclicals ETF (NYSEArca: RWDC) provides a means to not only see defensive sectors perform well, but a way to capitalize on their outperformance compared to cyclical sectors.

RWDC seeks investment results that track the MSCI USA Defensive Sectors -- USA Cyclical Sectors 150/50 Return Spread Index (the "index"). The fund, under normal circumstances, invests at least 80% of its net assets (plus borrowing for investment purposes) in securities that comprise the Long Component of the index or shares of exchange-traded funds ("ETFs") on the Long Component of the index. The index measures the performance of a portfolio that has 150% long exposure to the MSCI USA Defensive Sectors Index and 50% short exposure to the MSCI USA Cyclical Sectors Index.

For more relative market trends, visit our Relative Value Channel.