Recessions are such indelible parts of the market cycle that they are akin to natural phenomena. For every boom, there is inevitably a bust. As I discussed in an article for GuruFocus earlier this week, while an economic downturn can be delayed (especially when the central bank fights to prevent it), it can never be prevented. Indeed, it is often the case that the longer the inevitable is delayed, the more painful the eventual reckoning will be.

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- The intrinsic value of BAC
- Peter Lynch Chart of BAC

Given the scale of the financial pain that even minor recessions can inflict on investors' portfolios, it is unsurprising that many indicators have been identified - and assiduously tracked - that may forewarn of impending crisis. One of the most famous of these indicators is the inverted yield curve.

**Harbinger of recession**
Yield Curve Inventor Warns Investors to Prepare for Recession

situation in which long-term debt instruments have lower yields than short-term debt instruments of the same credit quality. The yield curve is a graphical representation of yields on similar bonds across a variety of maturities. A normal yield curve slopes upward, reflecting the fact that short-term interest rates are usually lower than long-term rates. That is a result of increased risk premiums for long-term investments."

When discussing the yield curve, investors usually refer specifically to the yield curves of Treasury bonds. When the Treasury yield curve inverts, it usually means something is wrong. Historically, the yield curve inverts shortly before a recession hits. This occurred before the recessions of 1981, 1991, 2001 and 2007.

Consequently, yield curve inversion has come to be seen by many analysts, investors and policymakers as a sign of economic danger, even a harbinger of imminent recession.

Fighting fate

Given its track record as a powerful indicator of impending recession, it is no surprise that markets were roiled when the yield curve inverted on Dec. 3, 2018. Fears of looming crisis sent stocks tumbling and added to significant volatility through early 2019. However, while the yield curve’s recent inversion was seen initially as an ill omen by many market participants, life seemed to carry on largely as normal in the subsequent weeks and months. This led Bank of America Corp. (NYSE:BAC) economists Ethan Harris and Aditya Bhave to ponder in an April research note whether the inverted yield curve was still a useful indicator.

inverted on March 22 for the first time since the financial crisis when a surge of bond buying, driven by lower growth projections and the prospect of Fed easing, upended the gap between three-month and 10-year yields. Meanwhile, the spread between 2-year and 10-year yields has stayed near some of the flattest levels in more than a decade since December. In fact, the Fed has the power to 'prevent or quickly undo' an unwanted inversion, the BofA economists said. With central banks operating on both ends of the curve, 'the level of the curve matters more than the slope," they said. The Fed "is not sleep-walking over a cliff and 'has concluded that an inverted curve is not what it used to be and never was the sole relevant financial indicator."

In other words, despite its predictive power during cycles, economists are skeptical of yield curve inversion this time around. With an activist Federal Reserve doing everything it can to prevent a recession, this is perhaps an understandable conclusion.

**Not so fast**

While Bank of America may be willing to jettison the inverted yield curve as a powerful gauge of recession risk, the indicator's most well known pioneer continues to believe in its power. According to Professor Campbell Harvey of Duke University, investors should be girding themselves for recession:
As comforting as the Bank of America economists’ conclusions may be to investors hoping for the good times to keep on rolling, the historical predictive power of the inverted yield curve cannot be ignored.

**Story continues**