"The Coming Recession"

The recessions of 2000 and 2008 – and accompanying huge stock market declines - have left many investors fearful of the next big economic downturn. Yet for 8 years, each market drop or dire prediction about the economy has been nothing but a false alarm. Surely we are due for another recession before long, but can we forecast when, and do we know how might it affect us as investors?

Do Bear Markets Lead to Recessions? Not always, nor do all recessions see a market drop of 20% or greater (a bear). In 1966, Nobel winning economist Paul Samuelson quipped that the stock market predicted 9 of the last 5 recessions. In other words, bear markets presaged recessions only about half the time. And during 4 of the last 9 recessions, stocks (S&P 500 Index*) actually rose.

What Exactly *is* a Recession? The private, non-partisan, National Bureau of Economic Research (NBER) announces the onset and termination of recessions. While popularly defined as two consecutive quarters with a decline in Gross Domestic Product (the value of all goods and services produced), the NBER more broadly defines a recession as "a significant decline in economic activity spread across the economy and lasting more than just a few months."

When You're Told it's a Recession, it's Already Half Over: The NBER *always* calls recessions in hindsight . . . they never tell us it's on its way. They called the 2007-2009 recession 11 months after it started, and average telling us we're in a recession from 6-21 months after it's begun (source, NBER.org). They don't want to pull a false alarm. They want to know that the diminishing economic activity is real, and lasting more than a month or two. They want to be accurate.

What Goes on During a Recession: All recessions are different, but you'll see a slowdown in the economy, and that often results in less hiring and a rise in unemployment. Inflation may climb, and the Federal Reserve may hike interest rates. Housing and commodity prices may tumble off inflated highs, and the stock market will often experience big sell-offs. Investors may wait many months until the signs are more positive.

What's the Damage From a Recession? You may see a drop in your home value or you might even lose your job. But, for most of us, the most obvious pain comes from the temporary decline in our investments, which we are reminded of daily by the media. The year prior to recessions, the markets underperform their averages. And during the last 9 recessions the S&P 500* return has been -7.4% on average (Advisor Perspectives). But the 1, 3, and 5 year returns *after* the end of a recession normally see returns which are significantly above average. In past recessions investors have been rewarded for sticking it out - or even investing - during such periods of unrest.

The Pain is Temporary: According to NBER data reported by J.P. Morgan Asset Management, since the year 1900, recessions have lasted an average of 15 months . . . and periods of economic expansion (rising economic activity) have lasted an average of 46 months. That's the same ratio, 3 to 1, of the length of bull markets over bear markets over the last 75 years (Putnam Investments).

What Should Investors Do? While we can't predict recessions and bear markets (they are not necessarily coincident), we do know that certain asset classes have done much better than others during these tumultuous times. Stocks of all types have fared much worse than fixed income and cash during recessions. But knowing if/when to shift is problematic, and leaving money to languish in cash only to weather 3 or 4 false alarms while stocks soar is a sure way to paltry returns. Having a balanced mix is the best tactic for most of you.

Why Do We Say 'Coming Recession'? Because it's inevitable. Even though the frequency of recessions has slowed in the last 3 decades to one every 10 years, it *will* happen . . . and we're just about 10 years out from the beginning of the last one. So, the calendar indicates that we're "due." We don't see a failing economy, roaring inflation, an overzealous Fed, or a bubble in commodities, though. To the contrary, things look pretty good right now.

The scars we carry from the recent recessions and bear markets remind us that we can't be complacent just because we're happily enjoying the 4th longest economic expansion since 1900.

Bitter conditions will confront us again, and knowing how to prepare can give you some cover. Understanding that the ill winds are temporary is truly empowering. Give us a call. We can get you through it.

**All indices are unmanaged and investors cannot invest directly into an index. Unlike investments, indices do not incur management fees, charges, or expenses. Past performance does not guarantee future results.*

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