Markets and Recessions

AUTHORED BY: ROB RICHARDSON, CFA; AUGUST 10, 2022

283 West Front Street | Suite 302 |Missoula, MT 59802
406.721.0999 | sglongfinancial.com

There has been a lot of debate the past several months on the likelihood of the US entering a recession. For months economist, politicians, news commentators, and many more have voiced opinions on the prospects of a recession ranging from imminent to unlikely.

WHAT IS A RECESSION?

One of the issues is that there can be almost as many interpretations of what constitutes a recession as there are on the probability of one. Perhaps one of the most common definitions of a recession is two consecutive quarters of negative gross domestic product (GDP) growth. With the preliminary second quarter GDP data being released at the end of July that criteria appears to have been met with GDP contracting at an annual rate of 0.9% following a contraction of 1.6% in the first quarter.

The National Bureau of Economic Research is the government agency that makes the official call on the beginning and endings of recessions, so it is still possible that we are not currently in an official recession. However, seeing as the economy is clearly not firing on all cylinders, we believe looking at how markets have behaved during past recessions could prove insightful.

WHAT COULD MARKETS DO?

When it comes to markets and economics it is often the case that there can be a disconnect between what is happening on Wall Street and what the average everyday person on Main Street is experiencing. Financial markets are forward looking while economic data is typically backward looking, meaning investors are often more concerned with what expectations going forward look like while economic data tells us what conditions were like in the recent past. This can result in financial markets rallying while the most current economic data may still look challenging, and conversely markets can sell off even when economic data looks positive.

This pattern plays out when we look at the S&P 500 and recession data. Since 1950 there have been 11 official recessions with the longest (the global financial crisis) lasting 18 months and the shortest (COVID-19) lasting 2 months. On average, during this time period recessions have lasted roughly 10 months, or just over three fiscal quarters. Of course, several recessions during this time frame have lasted much longer than average with the mid-70's Oil Embargo/Stagflation, Dot-Com Bubble, and Great Recession periods lasting 16, 17 and 18 months, respectively (see data table on next page for additional detail).[1]

1 – NBER.org, Bloomberg

Recession	Start Date	End Date	Length (months)	Market Low Date	% of Recession After Market Low Date*
Post Korean War	Jul '53	May '54	11	9/14/53	75%
Asian Flu Pandemic	Aug '57	Apr '58	9	10/22/57	66%
Nixon Recession	Apr '60	Feb '61	11	10/25/60	32%
1960s Expansion	Dec '69	Nov '70	12	5/26/70	47%
Oil Embargo – Stagflation	Nov '73	Mar '75	16	10/3/74	31%
Energy Crisis	Jan '80	Jul '80	7	3/27/80	53%
Double Dip Recession	Jul '81	Nov '82	17	8/12/82	17%
Gulf War	Jul '90	Mar '91	9	10/11/90	58%
Dot-Com	Mar '01	Nov '01	9	9/21/01	17%
Great Recession	Dec '07	Jun '09	18	3/9/09	15%
COVID-19	Feb '20	Apr '20	3	3/23/20	15%

* % of Recession After Market Low Date measures the amount of time, in percentage terms, that the economy remained in a recession after the market hit its low-point. A lower value would indicate that the market low during the recession occurred closer to the end of the recession.

Notes on Timing and What to Do With This Information

It's important to note how the timing of GDP works when looking at the market data. The "preliminary," or first iteration of the data doesn't typically come out until nearly a month after the end of the quarter. So for a standard "two quarters of negative GDP" recession the economy could have already been in a recession for seven months, or for approximately 70% of the length of an average 10 month recession.

In every one of these recessions the S&P 500 (the market) bottomed before the official end to the corresponding recession. In fact, the average date the market reached its recession low was just over two quarters from the official recession start date, meaning it's possible that during these recessions the market bottomed before the preliminary data on a second consecutive quarter of negative GDP was even released.

What this means for investors is that from a historical perspective the stock market doesn't tend to wait for a recession to end before starting the next rally. Of course, things could be different this time and markets may wait to rally until economic data improves, or perhaps we never actually enter an official recession. However, historical precedent can be a good guide and financial markets are forward looking.

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