FERGUSONJOHNSON
WEALTH MANAGEMENT

Is a Recession Bullish?

October 2022

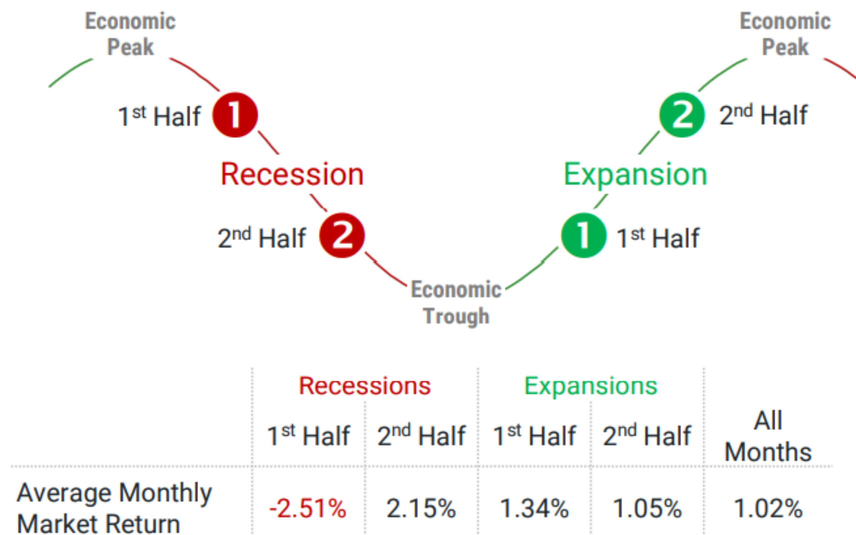
Once again, worldwide equities and fixed income declined over the past quarter under the backdrop of the familiar issues of inflation, hawkish monetary policy, sharply rising interest rates, and geopolitical strife. It's been a horrible year for investors – there's no denying that.

As we stand now, 2022 ranks as the sixth-worst year for the S&P 500 *ever*[1]. Three of the six years that clocked in lower were during the Great Depression and a fourth was 2008, the height of the Great Financial Crisis (the other year was 1974, for those curious).

While there are certainly factors that make us feel uneasy about the current state of the economy, is what we've experienced this year on par with the catastrophes listed above? I'm inclined to say no. We may already be in a recession, but even that's still unclear. Statistically we can probably say we *are* in a recession - GDP declined for consecutive quarters. However, jobs are continuing the be added month-over-month and consumer spending has yet to abate – making this the most bizarre recession ever.

The stock market has certainly behaved like we are in the first half of a recession. If that is the current circumstance, then there is a very bullish case to be made for where we go from here.

US Stock Performance during First and Second Halves of Recession & Expansions



	Recessions		Expansions		
	1st Half	2nd Half	1st Half	2nd Half	All Months
Average Monthly Market Return	-2.51%	2.15%	1.34%	1.05%	1.02%

Source: Avantis[2]

What stands out is that the below-average returns we've seen historically during times of recession have been driven by significantly negative returns during the first half of the recession. In the second half of recessions, returns have been strongly positive and far above the average monthly return. Good times have historically continued during the first and second halves of expansions.

What do these returns tell us? In the first half of recessions, markets react quickly to possible bad news. Expectations of lower company earnings during an economic slowdown and, more importantly, lower risk appetite due to increasing uncertainty, for example, are quickly reflected in lower stock prices.

It is important, and especially so during difficult market conditions, for investors to focus not solely on where returns have been but also on where they could be going in the months and years ahead.

In that context, let's look back to the last time we encountered some of the inflationary and potentially recessionary economic conditions we're currently enduring. We now have the compound wisdom to know just how wrong an infamous 1979 *BusinessWeek* cover story turned out to be when it declared "The Death of Equities." Eventually, *BusinessWeek* rolled into Bloomberg's publications. Forty years later, in 2019, a Bloomberg columnist described how they were "still getting grief" about it:

> "Three years after ["The Death of Equities"] appeared, the stock market hit bottom and then began a remarkable resurgence. The total return on the Standard & Poor's 500-stock index since its 1982 low, with dividends reinvested, has been nearly 7,000%. Not bad for a corpse."[3]

It would've been a bad idea to give up on capital markets in 1979. It remains a bad idea to give up on them today, especially given the compound wisdom we've acquired since then. Durable, well-diversified asset allocation remains our best strategy in bull and bear markets alike.

Historically, times like these have shown to be the some of the best times to be invested. Putting aside the Great Depression, here are how markets have behaved going forward from a decline of 25% or greater:

<u>Forward returns for the S&P 500 after it has fallen 25% from all-time highs</u>

Peak	Trough	% Decline	+1 Year	+3 Years	+5 Years	+10 Years
12/12/61	6/26/62	−28.0%	31.2%	69.2%	94.8%	171.1%
11/29/68	5/26/70	−36.1%	32.2%	44.3%	27.9%	97.5%
1/11/73	10/3/74	−48.2%	1.4%	23.8%	42.0%	188.4%
11/28/80	8/12/82	−27.1%	43.9%	81.2%	238.6%	403.9%
8/25/87	12/4/87	−33.5%	14.7%	34.1%	96.8%	387.1%
3/24/00	10/9/02	−49.1%	0.2%	1.9%	21.5%	38.3%
10/9/07	3/9/09	−56.8%	−6.9%	3.7%	61.2%	209.6%
	AVERAGES	**−39.8%**	**16.7%**	**36.9%**	**83.3%**	**213.7%**

Source: A Wealth of Common Sense[4]

As we've stressed before, financial plans are built on the expectation that market declines will strike at various points over multi-decade time horizons. For the overwhelming majority of our clients, we have confidence in the success of their financial plans in spite of this. However, that confidence evaporates when the investment strategies or savings plans are altered or abandoned out of fear.

Our advice this round is simple: zoom out. Pay attention to past years that you've had losses, and how quickly you minimize those in hindsight. The current time always feels bad, but how much time have you spent thinking about the losses in 2020 or late 2018 or late 2015 since we left those moments?

Market downturns are like traffic lights. When we drive, we may be slowed by red lights, but that doesn't prevent us from proceeding to our destination. If we choose not to drive to avoid being stopped at red lights, we can't get to where we want to go.

[1] Source: Morningstar. Data from January 1 1926 to September 30, 2022 .
[2] Source: Avantis. Data from 1973 – 2021. The market is represented by the CRSP U.S. Total Market Index. Source: Avantis Investors. The average number of months over the period from Peak to ½-Trough and ½-Trough to Trough is 5.4, while the number of months over the period from Trough to ½-Peak and ½-Peak to Peak is 35.9.
[3] Coy, Peter. *It's Been 40 Years Since Our Cover Story Declared 'The Death of Equities'.* Bloomberg. August 13, 2019.
[4] Carlson, Ben. *Bear Market Opportunities For Every Generation of Investors*. A Wealth of Common Sense. October 18, 2022.

Past performance is no guarantee of future results.

This newsletter contains general information that may not be suitable for everyone. The information contained herein should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Investment advisory services offered through Ferguson-Johnson Wealth Management, a registered investment adviser.