FERGUSONJOHNSON
WEALTH MANAGEMENT

Recession Anxiety

July 2022

It's been a brutal start to 2022, there's no other way to describe it. The S&P 500 is down 20%, the NASDAQ is down over 30%, and even bonds are 10% off their highs to start the year[1]. In fact, the first half of 2022 is the worst performing six-month period for US Treasury assets since the 1700's – that's not a typo. Even if we look outside of traditional asset classes, everything is hemorrhaging. Gold, the ever-heralded inflation hedge, is negative on the year[2]. Bitcoin is down over 50% with most other cryptocurrencies even further off[3].

So, what's the cause of all this and when might we be able to expect relief? Obviously, the keyword of the day is recession. Media and public sentiment certainly seem to suggest that a recession is imminent (or that we're already in one). Officially, a recession is a significant decline in economic activity spread across the economy that lasts more than a few months. That's pretty vague. Unofficially, lots of people use the metric of two quarters of negative GDP growth as the signal of a recession. But, that is inherently backward looking and isn't really helpful for those of us living in the moment. We can try to look at data and obviously a big data point is inflation, but inflation is just one variable in the economic equation, albeit an important one.

As we know, inflation is high. In theory, high inflation should lead to a decline in consumer spending, which should hamper the performance of companies, which should lead to lay-offs and lower wages, which should lead to a further decline in consumer spending, which should lead to… you see where I'm going. On top of that, the Federal Reserve is committed to hiking interest rates in an effort to try and combat inflation, which should further constrain companies and individuals. Whether or not this strategy will work is dubious as inflation seems borne out of things like the War in Ukraine and the Global Pandemic, rather than access to cheap capital. The Fed's toolkit is designed to nudge demand, not increase supply, which is really what we need. Jerome Powell's comment last month saying "we understand better how little we understand about inflation" certainly did not inspire much confidence.

That all tracks and seems pretty bad – good evidence of a recession, right? Well, the latest employment numbers indicate that companies are still hiring en masse with record high job openings and very low unemployment. Consumer spending remains strong, despite higher prices across the board. American households are still well capitalized[4]. These are all things that don't happen as the U.S. enters recessions.

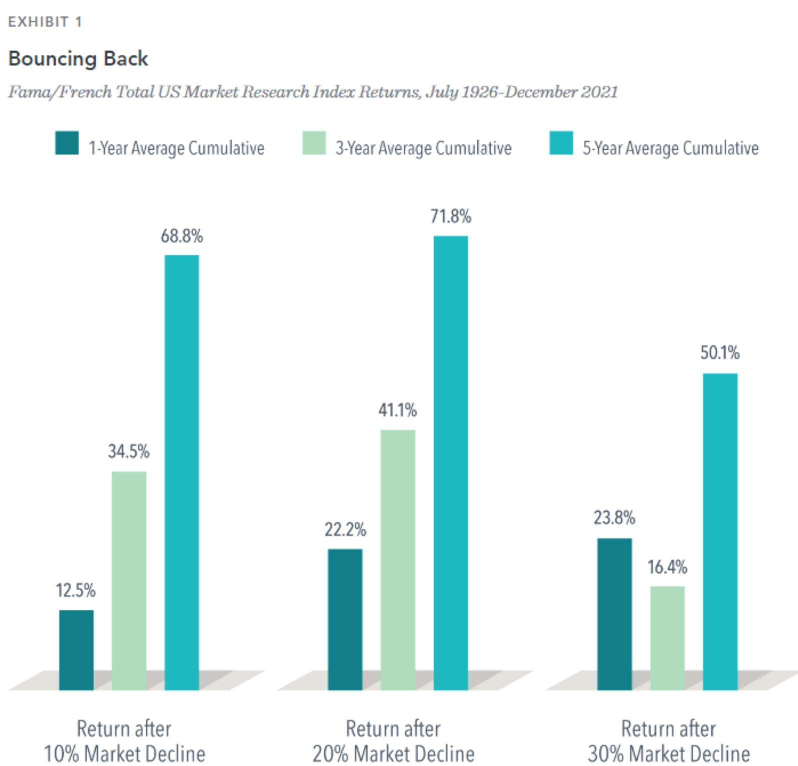
Honestly, things are kind of weird**.** Added to our economic quagmire are the myriad socio-political challenges that further exacerbate our feelings of discontent**.** What we have a whole lot of right now is stress and uncertainty all over the place, but our lives haven't really been upended - at least not yet. Derek Thompson at *The Atlantic* coined the concept of the *'Everything is terrible, but I'm fine'* phenomenon which, I think, may offer as good an explanation as anything of what we've experience over the past year-or-so.

The bottom line is a lot of people are stressed out about a lot of things right now. Markets are down. Prices are up for many of the things you need to buy. Interest rates are rising and make it a confusing time to consider buying or selling a house, or making other major financial decisions. This all adds to the stress you may be feeling about your job, the ongoing pandemic, and the health of loved ones. So, what does this mean for my investments?

We have to accept that these shocks will happen. We should prepare for them rather than try to predict them. This time there is inflation, fear of a recession, a war in Ukraine, and increased volatility. We don't know when this will end. We also won't know exactly what will cause the next shock or when it will occur. The only thing we can guarantee is that it's going to be a surprise (because if it weren't, the market would have priced that in).

As a long-term investor, here's the good news: You can capture the returns of the market without having to accurately forecast (which is great, since almost no one is consistently good at that). In times like this, when stock prices go down, the market is setting prices so shares will have a better return and attract buyers. When you see a big drop, prices are lower so that, going forward, the people who buy have a greater chance of having a positive outcome.

It also helps to remember: Every recession has eventually ended, with economies and markets thriving thereafter. As illustrated below, one-, three- and five-year average cumulative returns after significant U.S. stock market declines dating back to July 1926 have all been positive, rewarding investors who placed their faith in future expected returns. Since markets are ultimately driven by the underlying growth in global commerce, we can expect similar aggregate performance moving forward in domestic and international markets alike:



Source: Dimensional Fund Advisors, data as of December 31, 2021 (see footnotes for further information[5])

When you can be a long-term investor and think in terms of decades rather than years, you have the greatest chance of capturing the power of compounding. Those little extra gains add up over time. It helps explain why over the past 95 years (including all those shocks that have happened), the return for the general stock market has been around 10% a year[6]. Markets rarely return 10% in any one year, but over time, long-term investors have been rewarded with that longer-term average. I think that's amazing. However, I also know it's tough to stick it out because it means that you have to get through these tough times, even when the market has gone down and down. We trust our investment and planning processes, but if we need to go over it again - please know that we are always here for you.

[1] Source: Morningstar, data as of June 30, 2022.

[2] Source: YCharts, data as of June 30, 2022.

[3] Source: Coinbase, data as of June 30, 2022.

[4] Source: Economic Research Federal Reserve of St. Louis, data as of May 31, 2022.

[5] In USD. Market declines or downturns are defined as periods in which the cumulative return from a peak is –10%, –20%, or –30% or lower. Returns are calculated for the 1-, 3-, and 5-year look-ahead periods beginning the day after the respective downturn thresholds of –10%, –20%, or –30% are exceeded. The bar chart shows the average returns for the 1-, 3-, and 5-year periods following the 10%, 20%, and 30% thresholds. For the 10% threshold, there are 29 observations for 1-year look-ahead, 28 observations for 3-year look-ahead, and 27 observations for 5-year look-ahead. For the 20% threshold, there are 15 observations for 1-year look-ahead, 14 observations for 3-year look-ahead, and 13 observations for 5-year look-ahead. For the 30% threshold, there are 7 observations for 1-year look-ahead, 6 observations for 3-year look-ahead, and 6 observations for 5-year look-ahead. Peak is a new all-time high prior to a downturn. Data provided by Fama/French and available at mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html

[6] In US dollars. S&P 500 Index annual returns 1926–2021. S&P data