INVESTMENT PERSPECTIVES

April 2023

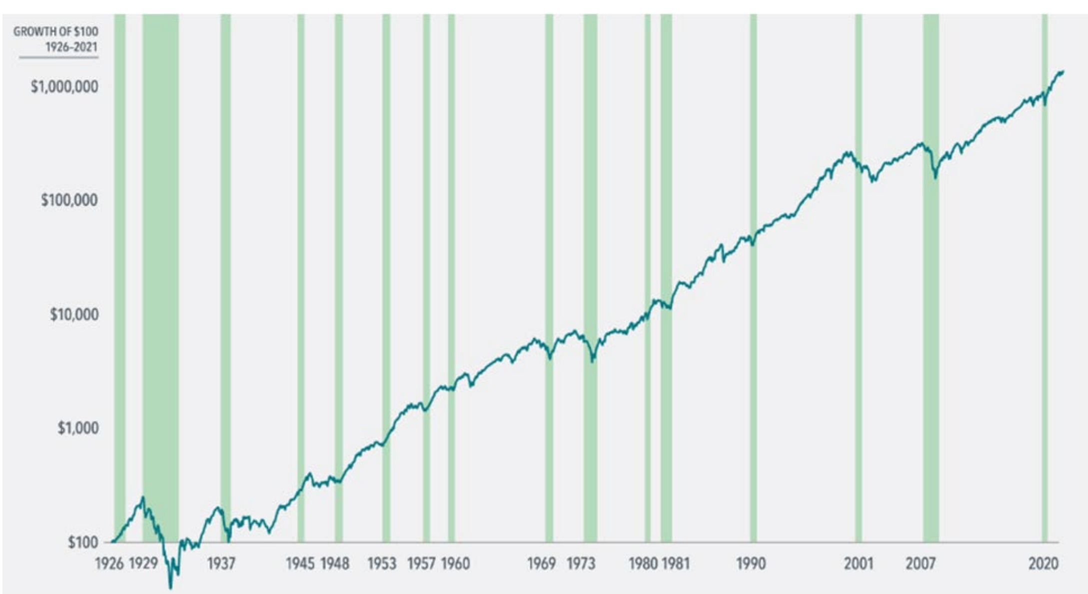
Navigating a Recession: Around or Through?

For many economists and market experts, the much-anticipated economic recession has been looming over the market for quite some time. Unsurprisingly, prognostications have ranged from avoiding a recession completely to entering a prolonged period of economic contraction. So where does that leave us as investors? Can portfolios be repositioned to simply avoid the negative impacts of an impending recession? Unfortunately, history has shown us that it is rarely, if ever, that simple. The lasting impacts of getting these decisions wrong often leads to a substantially worse result than doing nothing at all. With that as a backdrop, in this *Investment Perspectives* we'll explore recessions from a historical context and the challenges they pose.

The Timing of Recessions

The National Bureau of Economic Research (NBER) is a private nonprofit research organmization that according to their website, is "committed to undertaking and disseminating unbiased economic research among policymakers, business professionals and the academic communtiy." Among other initatives, they are responsible for declaring the start of recessions and the completion or end date of recessions. The NBER defines a recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months." Is the dating of a recession actionable information that investors should be following? In short, not really; it is inherently a backward-looking determination, and we know that markets are forward-looking. Historically, the announcement of recessions has occurred after they're already in progress and the eventual end of recessions has been declared after an economic recovery has already taken hold.

What does nearly a century of economic cycles teach us about investing? The graphic below shows recessionary periods, shaded in green, between 1926-2021.



Source: Dimensional Fund Advisors

This is overlayed by a line chart that depicts the growth of $100 invested in US stocks during that same period. What stands out to us about this chart? Firstly, the markets have rewarded investors even when economic activity was still contracting. This is an important example of the forward-looking character of markets. Secondly, the overwhelming difficulty faced by an investor trying to time their exit and re-entry into the market. Cleary, nearly 100 years is not an applicable time-horizon for most investors but what is also clear, is the duration of actual recessions is very short in comparison.

<u>How do we respond?</u>

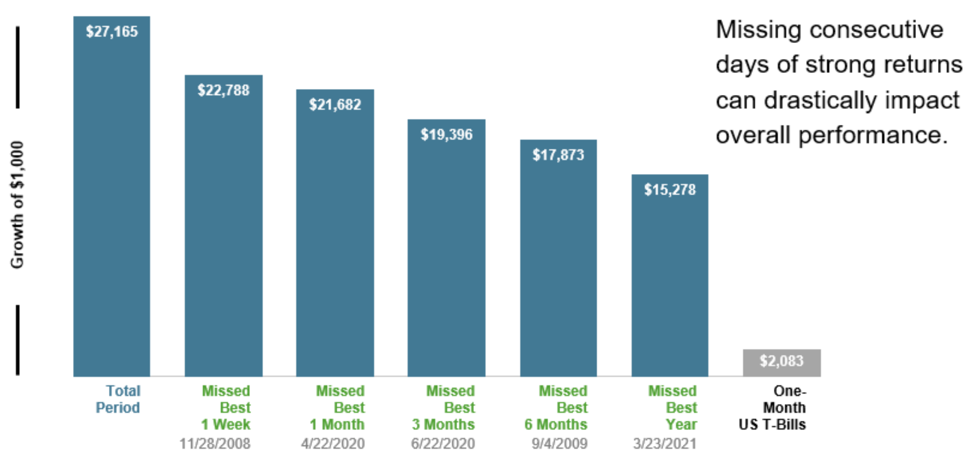
According to data provided by Vanguard, there are several key takeaways from the historical performance of stocks during recessions.

- **Stock recoveries may begin soon after recessions commence.** Over the last half century, the earliest recessionary recovery in stocks began just two months into the brief economic downturn of 2020. The latest recovery started 16 months into the recession of 2007–2009.
- **Recessions have been relatively short compared with most investors' time horizons.** The length of the last seven recessions varied, from just two months in 2020 to 18 months during the 2008 global financial crisis. Of course, recent experiences do not preclude a longer recession.
- **Investing defies certainty.** We don't know how long any recession may last or how long equity market recoveries may take. Indeed, as mentioned previously, official declarations of recessions by NBER are backward-looking. A recession can end before it's been declared, reflecting the challenge economists face in assessing the level of growth in real time.

Source: Vanguard

While market declines can be scary and difficult, they should be viewed as opportunities to make investments at valuation levels that are more attractive due to recent declines. Attempting to time the market on a wholesale basis or waiting for an "all clear" signal can have a lasting negative impact on returns, as shown below.

Performance of the S&P 500 Index, 1991–2021



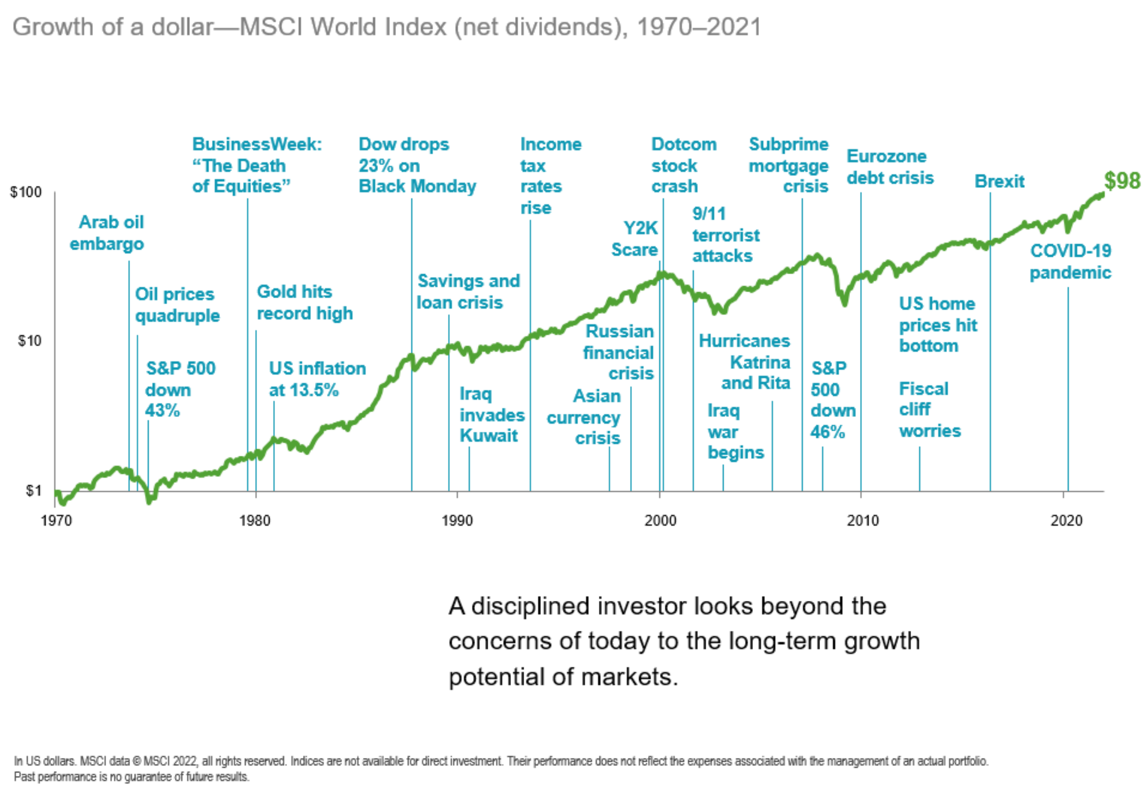
Annualized Compound Return	11.24%	10.61%	10.43%	10.04%	9.75%	9.19%	2.40%

Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.
In US dollars. For illustrative purposes. Best performance dates represent end of period. The missed best consecutive days examples assume that the hypothetical portfolio fully divested its holdings at the end of the day before the missed best consecutive days, held cash for the missed best consecutive days, and reinvested the entire portfolio in the S&P 500 at the end of the missed best consecutive days. Annualized returns for the missed best consecutive days examples were calculated by substituting actual returns for the missed best consecutive days with zero.
S&P data © 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. "One-Month US T- Bills" is the IA SBBI US 30 Day TBill TR USD, provided by Ibbotson Associates via Morningstar Direct. Data is calculated off rounded daily index values.

"Investors and managers are in a game that is heavily stacked in their favor. Charlie (Munger) and I believe it's a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the prediction of experts, or the ebb and flow of business activity. The risks of being out of the game are huge compared to the risks of being in it."- Warren Buffet, CEO, Berkshire Hathaway

As investors, we must accept that recessions are a normal part of the economic cycle, and most investors are going to experience several recessions over the course of their investing lives. Many in our social circles and the financial media have convinced investors that the way to make money is jumping in and out of the market based on a reading of the tea leaves. You'll be regaled with stories of the smartest investors who sold at the top and got back in at the bottom. This fairytale version of investing is often just that, a fairytale.

In the area of investing, the topic of "average market returns" is often discussed. What doesn't always get top billing is the myriad of economic, geopolitical, and other crises that occur over these same time periods. As you can see below, some of the events highlighted over the past 50 years had a huge impact on global stock performance but as you widen the timeframe, they appear far less dramatic than they felt in the moment.



Source:

While the current news headlines around inflation, interest rates and the most recent banking crisis can easily overwhelm, it can be helpful to look at past market volatility to understand that similar events have happened before (as shown above). While history doesn't repeat itself and the future is largely unknowable, putting current economic and market events into context can be beneficial. Staying committed and disciplined is so important during market downturns, avoiding the urge to lock-in losses or sitting on the sidelines too long and missing the impending recovery. Predictably, there is no shortcut to earning long-term returns. It has very little to do with your intelligence, but it is highly correlated with an investor's ability to filter out noise, control emotions and rely on logic when the world around them is telling them to panic.

The real investing challenges aren't centered around avoiding the next recession but rather, how can your money be best positioned to accomplish your long-term goals? Whether that be maintaining your standard of living and lifestyle for the next 30 years, paying for rising healthcare costs, or creating a financial legacy that will outlive you. These goals extend our time horizons beyond the coming recession or even the one that may follow. Long-term investing success equates to shifting our focus to years or decades, rather than weeks or months. Stocks have been a proven tool to help build wealth and outpace inflation over time. We believe this will continue to hold true in the future and it is why we continue to look for quality companies at a fair price for your portfolio--even with the potential of a recession around the corner.