Wentz Weekly

June 9, 2020

It's Official: U.S. Enters Recession

As we had thought we would be, following the shutdown of the U.S. and global economies due to the COVID-19 pandemic, the U.S. officially entered a recession in February. The start of the recession ends the 128-month long expansion, the longest economic expansion in U.S. history. The National Bureau of Economic Research (NBER), well known for declaring the start and end dates of recessions in the United States, made the official announcement yesterday.

Background on recessions:

The Business Cycle Data Committee of the NBER officially declares the starting and ending dates of a recession. The committee is made up of 10 well respected academic macroeconomists. The actual definition of a recession according to NBER involves "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." A recession is a broad contraction of the economy, not just one sector, where domestic production and employment are the primary measures of economic activity. A recession begins when the level of economic activity reaches a peak and ends when the level of economic activity troughs or begins to grow again.

Current Recession:

The Committee views employment, more specifically payroll measures based on a large survey of employers, one of the more important and reliable indicators in determining a peak in activity. As we know, there was a large increase in those laid off or furloughed, as well as a substantial increase in individuals filing for unemployment benefits beginning between February and March. The second most important and reliable indicator is gross domestic product (GDP). Since this data is released quarterly, the committee looks at consumption by consumers, which is 70% of GDP. The data indicated a clear peak in employment and consumption in February.

The committee weighs the depth and duration of a contraction in deciding to declare a recession. They determined due to the pandemic and the extreme response, which essentially shut down all economic activity, the characteristics of this recessions differed from prior recessions. However, the amount of the decline in employment and consumption and its broad impact on activity, even if the contraction is shorter than prior recessions, warranted the classification of a recession.

How long does the average recession last?

There have been 18 recessions in the United States post-World War I and the average length of those recessions have been 13 months. The 1918 recession, which occurred amidst the Spanish Flu, lasted 7 months, about half as long as the typical recession. Remember, the stock market is forward looking and anticipates economic recoveries. With the average length of a recession being 13 months stocks typically begin the recovery process 3 months prior to the end of the recession. We expect the current recession to be short and severe, which explains why we have witnessed an extremely quick recovery in the markets.

What is the stock market performance coming out of a recession?

Looking back at the ten most recent recessions, since post-WWII, the average peak-to-trough decline is -23.6%. The average performance of the S&P 500 six months after the trough is 24.1%, while the average 12-month performance is 32.4%.

Keep in mind that market selloffs happen much quicker than the recovery back to prior peaks. Selloffs of 15% or more since 1950 occurred 16 times with the average selloff of -27.8%, the average time from peak to trough of 9.5 months, while the average time to climb back to previous high is 13 months. This year's peak to trough was unprecedented and the quickest in history, taking less than one month and resulted in a decline of 35.4% for the S&P 500.

We believe we are seeing a cyclical bear market inside a secular bull market, in other words a short recession inside a long-term bull market. As figure 1 illustrates, we witnessed a 35% pullback, but we believe it occurred in the secular bull market we are currently in. As we go through market cycles it is important to consider your long-term investment goals and objectives. Figure 2 shows we typically always see intra-year declines in the stock market, on average -13.8%, but the annual returns have been positive 30 out of the last 40 years and have averaged 8.9%. History shows that missing the best days can significantly reduce portfolio performance and those days typically occur in recovery periods immediately after recessions or steep market declines. According to the figure 3, investors that missed the 10 best days of any given decade would have seen 70% lower returns over the course of that decade on average. These statistics emphasize why is important to maintain your investment strategy, avoid emotional decision, and always remember your long-term investment objectives.

Sources:
[1] Russell Investments: U.S. stock market returns during recessions.
[2] ClearBridge Investments: The Anatomy of a Recession: What to Look For and Where We're Headed (Second Quarter 2020).

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. Any opinions are those of the author, and not necessarily those of Raymond James. Expressions of opinion are as of this date and are subject to change without notice. Information contained herein was received from sources believed to be reliable, but accuracy is not guaranteed. Information provided is general in nature and is not a complete statement of all information necessary for making an investment decision and is not a recommendation or a solicitation to buy or sell any security. Investing always involves risk and you may incur a profit or loss. Past performance does not guarantee future results. There is no assurance these trends will continue, or forecasts will occur. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary.

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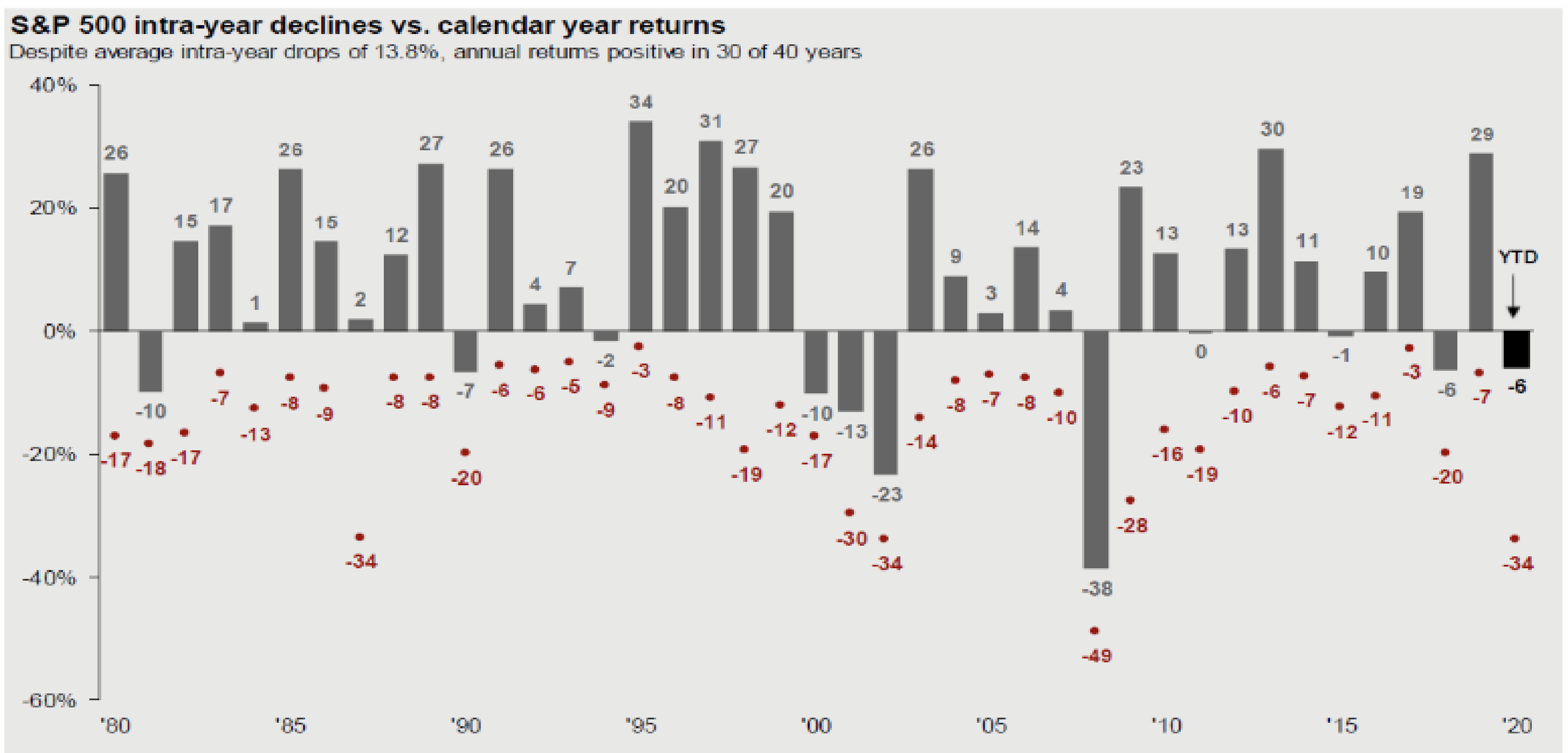
Figure 1

Note: Shaded areas indicate recessions.
Source: Bloomberg, Federated Hermes. As of April 2020.

Figure 2



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2019, over which time period the average annual return was 8.9%.
Guide to the Markets – U.S. Data are as of May 31, 2020.

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Asset Management

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Figure 3:

	Cumulative		Annualized	
Decade	**Price Return**	**Excluding 10 Best Days Per Decade**	**Price Return**	**Excluding 10 Best Days Per Decade**
1930	-42%	-79%	-5%	-15%
1940	35%	-14%	3%	-2%
1950	257%	167%	14%	11%
1960	54%	14%	4%	1%
1970	17%	-20%	2%	-2%
1980	227%	108%	13%	8%
1990	316%	186%	15%	12%
2000	-24%	-62%	-3%	-10%
2010	190%	95%	11%	7%
Average Since 1930	**114%**	**44%**	**6%**	**1%**

Data as of March 31, 2020. Source: ClearBridge Investments, FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses, or sales charges.