October 2019 – Navigating the Next Recession

I've heard there's going to be a recession. I've decided not to participate.
-Walt Disney

Stock Markets and the Economy

As the economy and political forces continue to dominate headlines and we approach the eleventh year since the global financial crisis, the question of the next recession's arrival is a common talking point. But when it does arrive, what will happen to stocks in general and our own investments in particular?

To help prepare ourselves for whenever the next recession happens, there are three key points to consider:

1. The economy and the stock market do not always correlate in the short-term. A bear market (a decline of 20% or more) may happen before a recession begins, and the stock market may rally before the economy has returned to growth. As we have noted before, timing the stock market is very difficult, if not impossible.

2. Recessions don't last forever. An investment plan built for your long-term financial goals should be designed to withstand the volatility during a recession.

3. Recessions and bear markets are normal and inevitable. In fact, we experienced a stock market downturn in 2018 that shared some similarities with previous recessions even though our economy continued to grow.

Stock Prices During a Recession

As we mentioned in our last quarterly letter ('Can Bad Things Happen to Good Economies?'), the stock market and the economy are sometimes two different things.

We examined the eleven recessions since the 1940's and included a table in the Appendix (Table 1) displaying the length of each recession and how the S&P 500 performed during that time. When looking at the results, it may be surprising that the market's performance during the recession was more often positive than not. This tells us that stock prices can be independent of economic data. Many times stocks begin to reflect improvements in the economy before the recession has officially ended.

We strive to design an investment plan that fits your risk tolerance and growth objectives and can persevere for the long-term even through periodic recessions.

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The low in the S&P 500 during the Great Recession occurred in early March 2009, a full quarter before the recession had officially ended in June 2009. If we had changed our investment plan and exited the market on a reactionary basis, we would have put your portfolio at risk of missing the recovery. Using a diversified portfolio of sound, proven companies relieves us of the burden of predicting when the market's turning points will occur.

The Reality of Recovery

Even though the market's historical performance during recessions may be a pleasant surprise, what matters more to our investing psychology is the time it takes after a market's decline to get back to break-even. We examined the recovery times for the last eleven bear markets, which can also be found in the Appendix (Table 2), and includes some of the more infamous periods including Black Monday in 1987 and the EuroCrisis in 2011.

The takeaway from this table is that the length of time from the stock market's peak to trough and back to a new high averaged 2.4 years. Whether we are investing for retirement in the next decade or investing for our children and future generations, we are planning for the days long after any bear market or recession, not during it. With that in mind, we may consider recessions as a source of opportunity rather than anxiety. If our plan is not to invest for the next six months or even six years but for the long-term, we can rest easier knowing there will always be a recovery at the end of the proverbial tunnel.

Conclusion

We should all appreciate what the market has done for us over the last twelve months. The market fell -19.36% from its peak on Sept. 20th 2018, to its trough on Dec. 24th 2018. After 2018, very few predicted the market to behave as favorably as it has in 2019. We all must have a plan that allows us to navigate through such turbulence. Looking back, we recognize that focusing on long-term financial goals and staying the course led to better outcomes than attempting to outsmart and time the market.

The evidence shows that investing in a diversified core of quality companies, coupled with a long-term time horizon, helps us all to persevere during the gyrations of the business cycle and the market. By familiarizing ourselves with the nature of the recession/recovery cycle, we need not fear recessions. We should embrace them.

As always, we wish to thank you for allowing us to serve you and help you achieve your financial goals.

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Appendix

Table 1: Post-World War II Recessions

Recession	Length in Months	S&P 500 Total Performance
Dec. 2007 - June 2009	18	-34.84%
Mar. 2001 - Nov. 2001	8	-3.87%
July 1990 – Mar. 1991	8	5.92%
July 1981 - Nov. 1982	16	15.31%
Jan. 1980 - July 1980	6	10.93%
Nov. 1973 – Mar. 1975	16	-12.96%
Dec. 1969 - Nov. 1970	11	-4.17%
Apr. 1960 - Feb. 1961	10	14.80%
Aug. 1957 – Apr. 1958	8	-4.98%
July 1953 - May 1954	10	24.00%
Nov. 1948 - Oct. 1949	11	10.46%
Performance includes reinvested dividends Monthly S&P 500 price is the average of the daily index closing prices during that month		
Data Source: Robert Shiller, http://www.econ.yale.edu/~shiller/data.htm		

Table 2: Historical Bear-Market Recovery Time

S&P 500 Bear Market Period	% Drop Peak to Trough	Month of Recovery to a New High	Recovery Time Back to Peak (Years)
Sept. 2018 - Dec. 2018	-19.36%	April 2019	0.56
Apr. 2011 - Oct. 2011	-18.64%	Feb. 2012	0.77
Oct. 2007 – Mar. 2009	-55.25%	April 2012	4.48
Apr. 2000 - Oct. 2002	-47.02%	Oct. 2006	6.52
July 1998 – Aug. 1998	-19.19%	Nov. 1998	0.35
July 1990 - Oct. 1990	-19.18%	Feb. 1991	0.58
Aug. 1987 - Dec. 1987	-33.51%	May 1989	1.75
Nov. 1980 – Aug. 1982	-27.11%	Oct. 1982	1.29
Sept. 1976 - Mar. 1978	-20.11%	August 1978	1.32
Jan. 1973 - Oct. 1974	-48.20%	August 1978	5.62
Nov. 1968 - May 1970	-36.06%	Dec. 1971	3.08
		Average:	2.39
Performance includes reinvested dividends			
Data Source: YCharts S&P 500 Total Return Historical Prices and Robert Shiller, http://www.econ.yale.edu/~shiller/data.htm			

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