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COMMENTARY

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We are in a Recession Already

- While we are in a recession, we do not expect it to worsen into a depression.
- The current recession represents both a demand and supply shock. It is reminiscent of the 1970s recession.
- We expect markets to recover once there is more clarity around virus containment.

The National Bureau of Economic Research (NBER) defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in economic indicators such as gross domestic product (GDP), real income, employment, industrial production, and wholesale/retail sales. Given the recent sharp drop in economic data, we believe we are in a recession. While we anticipate the economy worsening before it gets better, we do not foresee an economic depression. We do expect the stock market to improve once investors begin to anticipate a recovery.

The economic fallout of the COVID-19 pandemic represents a rarity to our economy since it is simultaneously a shock, or an unexpected negative impact, to both the demand and supply sides. For example, one reason that caused the 2008 Great Recession was a sharp drop in both consumer and business spending. Health officials and government agencies continue to tell people to stay home and not go to shopping malls, eat at restaurants, or travel. This has caused a huge drop in consumer spending. Case in point, on the last day of March, 146,000 people passed through TSA checkpoints at domestic airports. On the same day last year, this number was well over 2 million people. Looking at the supply side of the economy, these same guidelines have limited worker travel, closed factories, disrupted supply chains, and impacted companies. For example, Dun & Bradstreet noted in a recent survey that 938 of the Fortune 1000 companies have reported that at least one of its tier one suppliers has been impacted by the virus.

Weaker consumer and business spending, along with supply chain disruptions, have been seen in recent data readings and suggest that we are already in a recession. Regional manufacturing surveys in New York, Philadelphia, Richmond, and Dallas, which represented the first look at March economic data, were all very disappointing. The March ISM Manufacturing PMI fell into contractionary territory. The labor market has also seen a sharp drop as reflected by the nearly 10 million Americans submitting new unemployment claims in just the past two weeks. Last Friday's employment report was also a shocker. The 11-year economic expansion, which added about 22 million to U.S. payrolls, has clearly come to a halt as 701,000 jobs were lost in March. More shocking is the fact that this report only represents data through March 12. The April employment report will include the 10 million who filed unemployment claims over the past two weeks plus this week's filings that should reflect a further jump as factory workers seem to be next in line as both airplane and auto manufacturers, along with their suppliers, have recently announced layoff plans.

Though we are likely in a recession today, we don't believe that we are headed into a depression as some worry. There is also no standard definition for a depression, but most define it as a more severe version of a recession. While we acknowledge that this current recession could linger longer than we originally anticipated, there are reasons why this recession is not likely to turn into a depression. The federal government has thrown significant monetary and fiscal stimulus at the economy in the form of lower interest rates and a combination of money sent to households and businesses. Also, the Great Depression did not have safety nets and assistance programs in place that we have today such as Social Security, Medicare, and Medicaid. These programs, along with government stimulus and enhanced unemployment benefits, will not prevent a sharp decline in near-term economic data, but they should help to support an economic recovery once the virus is under control.

Looking ahead, how will this recession play out? We believe the simultaneous impact on both the demand and supply sides of the economy lessens the likelihood of a so-called V-shaped recovery where a sharp drop in economic data readings are followed by a sharp rise to the previous peak. While government stimulus will help move the economy closer to a recovery, we are concerned about the fact that so many unknowns about the virus remain. Even if, and when, the government gives an "all clear" signal, consumers may be hesitant to spend as they did before. Social distancing and consumer apprehension to gatherings may weigh on the minds of Americans and keep spending in check. Keep in mind that after the Great Depression, the psychological impact changed Americans and our country became a nation of savers.

Instead of a depression or a V-shaped recovery, we feel that a more likely outcome is some type of "U-shaped" economy where data metrics will only gradually rise back over time. The combination of weak demand and a supply disruption at the same time from the virus is different than recent recessions. Instead, the current recession could be similar to the '70s recession when a sharp jump in unemployment and an oil shortage similarly hurt the demand and supply sides of the U.S. economy.

While there is still uncertainty about the economy, the stock market could be closer to a bottom for a few reasons. Monetary and fiscal stimulus should provide a temporary backstop and help market confidence until the economy recovers. Valuations are now more attractive than they were just six weeks ago. Low oil prices and near-zero interest rates are good for the consumer economy. Improvement in China suggests there is a light at the end of the tunnel. While all of these are potential positives for the stock market, we caution that the virus remains the primary overhang. Until it is brought under control, investor confidence will suffer. The good news is that the stock market tends to anticipate events about six to nine months in advance. Just as equities sold off in the first quarter in anticipation of the current economic recession, we believe markets will begin to start reflecting an economic recovery before it begins.

While it is difficult to pick a bottom in the stock market, we take comfort in the fact that the average peak (highest market level) to bottom of the last 10 recessions is -30.5% for the S&P 500. In the current market weakness, the S&P 500 had fallen as much as 33.9% from the February 19 closing price high. This suggests that we possibly witnessed most of the market decline already. With that said, now is not the time to be overly aggressive beyond your comfortable risk levels, as we still want more clarity around efforts to limit the virus. These are challenging times, but your financial professional can help you stay on course. It is important to review your financial goals and objectives periodically and focus on your long-term goals.

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