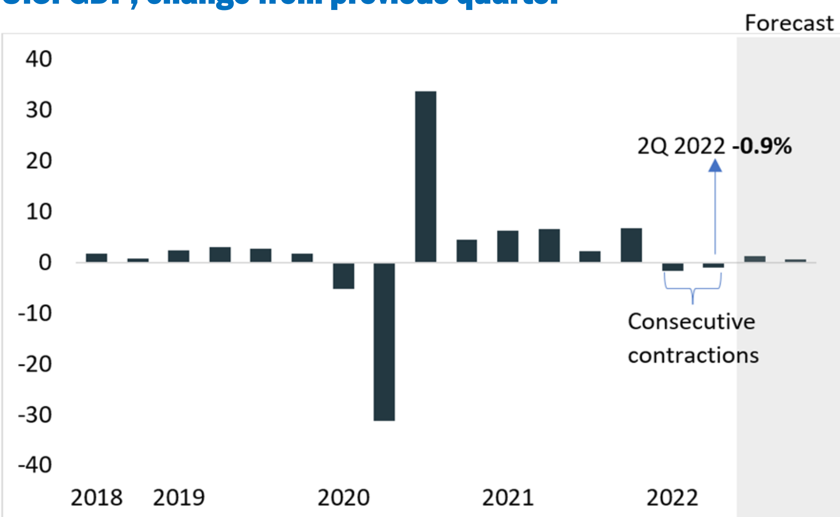
Markets in a Minute:
Recession - Does it Really Matter?

Last week, the Bureau of Economic Analysis reported that the US economy was estimated to have declined for the second quarter in a row, after adjusting for inflation. The release prompted the word "recession" to spring up in headlines right and left, leaving investors wondering if they should head for the hills. Before you hit the panic button, remember that by the time a recession is "officially" called, the markets have already dropped and in fact, often they have already begun to move up in anticipation of a recovery.

What do we know about economic growth?

- 2022 2Q real GDP growth was estimated to have fallen by 0.9% on an annualized basis, after having fallen by 1.6% in the first quarter.
- These numbers try to adjust for the overall rise in prices, meaning that the economy overall grew, but only because of the high rate of inflation.
- While housing activity and government spending declined slightly, the largest drag on growth came from companies that raised inventories at a slower pace than previous periods.
- Net exports improved after several quarters of declines. Consumer spending, though positive, grew at a slower pace.

U.S. GDP, change from previous quarter



Kestra Investment Management, Bureau of Economic Analysis, Wall Street Journal surveys of economists. Data as of August 2, 2022.

What exactly is a recession anyway?

- Traditionally, two consecutive quarters of negative economic growth is often referred to as a recession. But the actual timing and determination of what constitutes a recession is a bit more complicated.
- The National Bureau of Economic Research (NBER) is the official arbiter of when a recession is said to have started and ended. The NBER's Business Cycle Dating Committee defines a recession as "a significant decline in economic activity that is spread across the economy and that lasts more than a few months." They look at "depth, diffusion and duration" across a variety of factors.
- Unlike GDP, which is calculated by the quarter, the NBER's recession dating goes by month, making it a more precise measure, if more qualitative.

Should investors really care if and when a recession is called? There are reasons to not pay too much attention.

- Both GDP numbers and the NBER's dating of recessions come at a lag, sometimes a significant one. GDP growth estimates can also change, sometimes meaningfully and sometimes for quarters or years to come. So, what initially gets reported as a decline in economic activity can later be changed to an increase, and vice versa.
- Most importantly, the market moves much more quickly than the BEA or NBER. Stock prices tend to reflect the economic environment months in the future, or, at least, what they *think* will happen. Stocks are often wrong about what is to come.

"Wall Street indexes predicted nine out of the last five recessions! And its mistakes were beauties."

- **Paul Samuelson, winner of the Nobel Prize for Economic Sciences**

(continued on last page)

Summary

With the S&P 500 having fallen more than 20% from its peak through the end of June, the market has already priced in significant slowing of economic activity. Investors should do well to remember that the stock market is willing to sacrifice being wrong in favor of being quick, whereas the BEA and NBER choose accuracy over timing. So, the official signal that the economy is in recession often comes after the markets are already in recovery mode.

Instead of worrying about recessions as investors, we recommend a back-to-basics approach that ensures portfolios are properly diversified and assume a level of risk that makes sense for your long-term financial goals, risk tolerance and time horizon. With stocks, focus on companies with attractive valuations and high-quality earnings. These types of businesses have a history of withstanding short-term vagaries in the market and reliably delivering returns to shareholders even when the road gets bumpy.

As we've written before, and likely will again, if you're fretting about market gyrations, take your portfolio in for a checkup. Your advisor can ensure that your portfolio is properly aligned with your risk tolerance, which is key to meeting your financial goals.