Some Concerns of Investors Today

October 2022

Recessions and Effects on Market Returns

Jerome Powell, the Chair of the Federal Reserve, has been very direct with his messaging about continuing to raise interest rates in an attempt to decrease inflation back to near 2% and avoid a high inflation period similar to the 1970s and early 1980s. He also mentioned the possibility of the US economy entering a recession before inflation rates are brought down to the desired level.

Many investors are concerned about the impact a recession may cause on their portfolios. The table below shows the recessions in the US since the end of World War II with the returns of the S&P 500 before, during, and after the recessions. If we use history as a guide, market returns have been both positive and negative before and during recessions. But the 1-year and 3-year returns of the S&P 500 after a recession have shown a very strong trend of impressive returns.

S&P 500 Returns Before, During and After Recessions

Dates of Recession	1 Year Prior	During Recession	1 Year After	3Years After
11/1948 – 10/1949	+5%	+5%	+33%	+23%
7/1953 – 5/1954	+2%	+19%	+44%	+67%
8/1957 – 4/1958	-2%	-5%	+40%	+59%
4/1960 – 2/1961	+1%	+15%	+16%	+33%
12/1969 – 11/1970	-12%	-1%	+14%	+29%
11/1973 – 3/1975	-9%	-17%	+26%	+19%
1/1980 – 7/1980	+17%	+11%	+13%	+52%
7/1981 – 11/1982	+13%	+8%	+25%	+54%
7/1990 – 3/1991	+12%	+6%	+13%	+32%
3/2001 – 11/2001	-17%	-3%	-18%	+8%
12/2007 – 6/2009	+6%	-37%	+19%	+45%
2/2020 – 4/2020	+21%	-9%	+50%	
Average	+3%	-1%	+23%	+38%

PRATO CAPITAL

The stock market has reacted with increased volatility and sharp declines since Jerome Powell's speech on August 26 in Jackson Hole, Wyoming. As the bear market of 2022 continues, investors are also concerned about just how long it will be before the start of the next bull market. The reality is that only when looking back in time will we really know that the bear market ended, and the next bull market has started.

The chart below shows the history of both bull and bear markets since 1926. The US stock market has seen 17 bear markets, a drop of at least 20% from the previous high, lasting on average 10 months. Over the same period, the US has seen 18 bull markets, gains of at least 20% from the previous bear market bottom, lasting on average 55 months. When comparing bull and bear markets in the chart below, we can see that the S&P 500 spends considerably more time in bull markets. This chart also shows that bear markets happen and are a normal part of investing in the stock market. This signifies the risk and associated risk tolerance we often speak about when making a client's Financial Life Plan.

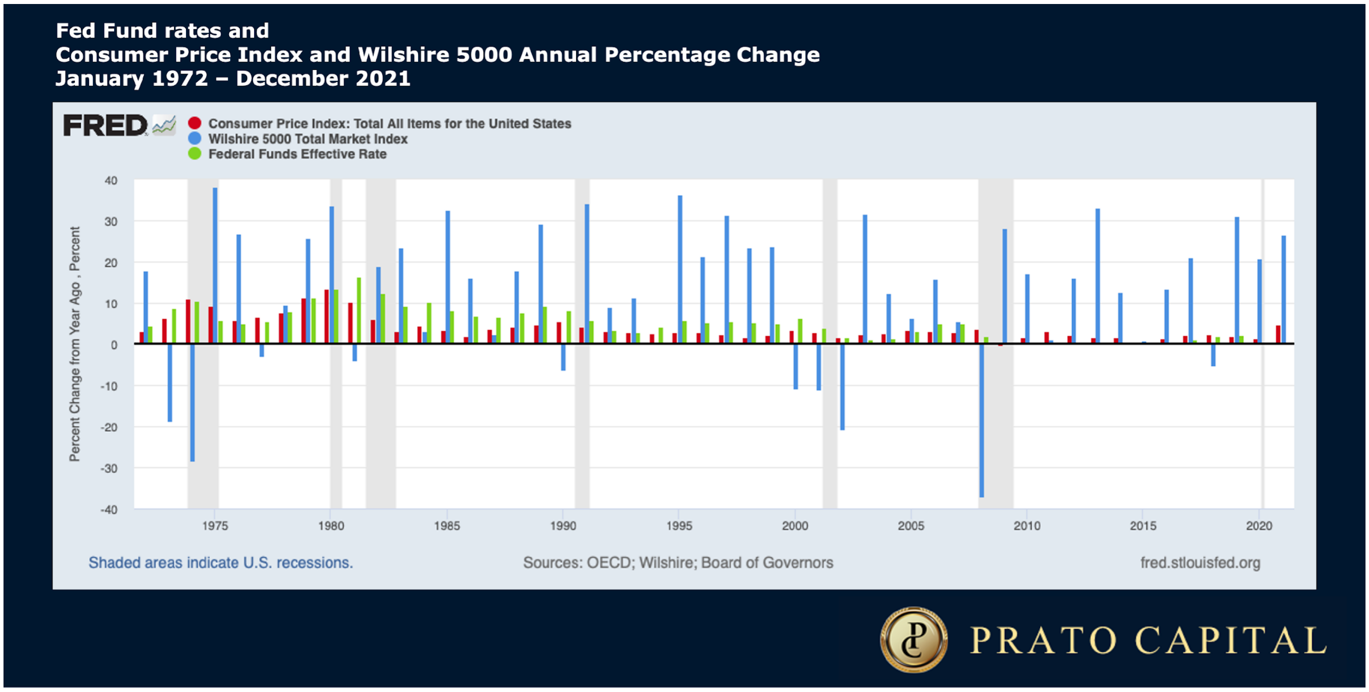
How to Outpace Inflation?

Inflation is a concern of everyone, especially those approaching or already in retirement. As costs for everyday items rise, we find our money doesn't go as far as it used to. Many investors seeking to stay ahead of inflation will invest in the stock market. With volatile and declining market values like we have seen this year, many ask if investing in stocks is worth the risk of market declines during any possible bear market. As discussed with the previous chart, bear markets have been on average much shorter in duration than bull markets. And the charts below show the advantage stock market returns have had when compared to rising inflation rates, even when looking back to the 1970s and 1980s.

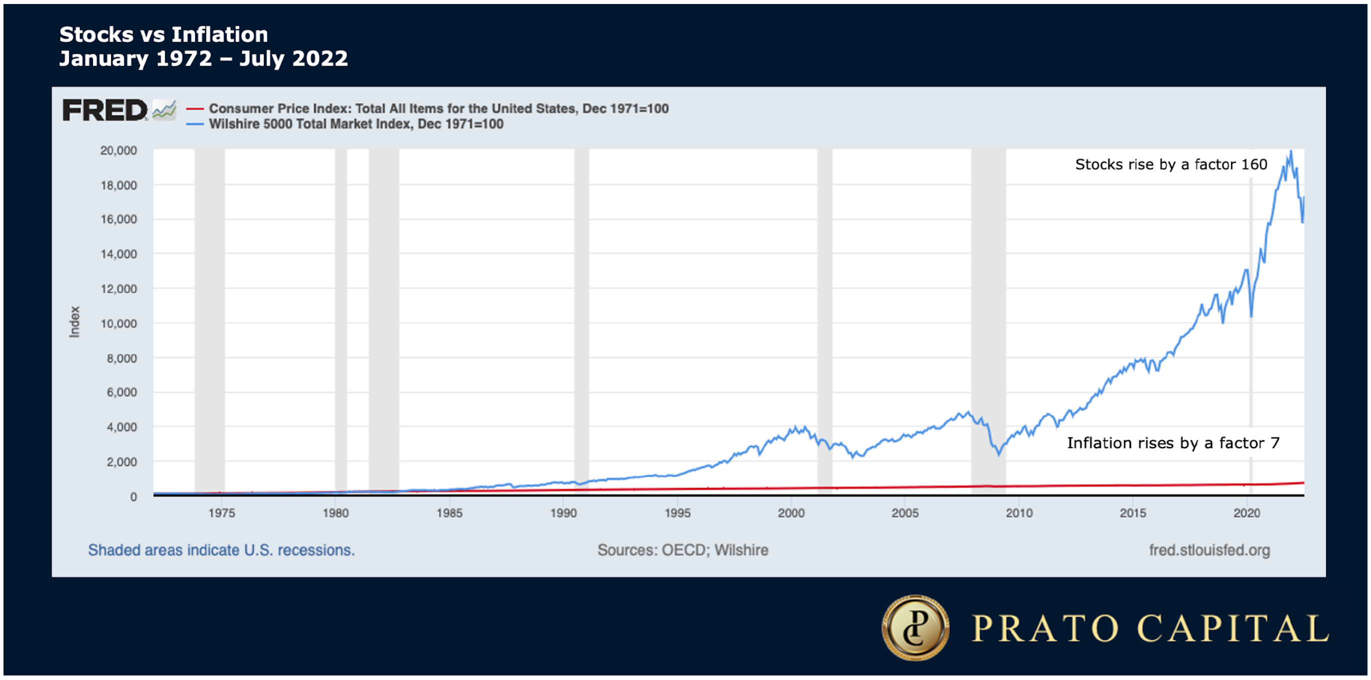
On the charts below, the red line is the rate of consumer inflation, the blue line is the annual return of the Wilshire 5000 market index with dividends reinvested, and the green line is the Federal Funds rate.[1] Shaded

[1] Wilshire 5000 is an index measuring the performance of all actively traded public US companies. It is not possible to invest directly in the Wilshire 5000 index.

areas of the graph indicate periods of the 7 recessions in the US economy since 1972. The US stock market has also seen 7 bear markets during this period.



Wilshire 5000 Total Market Index, Wilshire Associates, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WILL5000IND, September 29, 2022. The total market indexes are total market returns, which do include reinvested dividends. Copyright, 2016, Wilshire Associates Incorporated. Reprinted with permission. For more information about the various indexes, visit [Wilshire Associates](#).
Consumer Price Index: Total All Items for the United States, Organization for Economic Co-operation and Development, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPALTT01USM661S, September 29, 2022. Copyright, 2016, OECD. Reprinted with permission.
Federal Funds Effective Rate [FEDFUNDS], Board of Governors of the Federal Reserve System (US), retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/FEDFUNDS, September 29, 2022.



There are some short periods that inflation has outpaced stock market returns but over longer periods, stock returns have greatly outpaced inflation. The case for not investing in stocks due to the market declines like we have seen this year does not make sense. Stocks have significantly larger returns over time than the rate of inflation. And the reality is that returns on cash never beat a positive rate of inflation.

Alternative Investment Strategies

There are many analysts and commentators on the news talking about having 'cash on the sideline'. Some investors hear this and consider changing their investment strategy when the markets decline. The idea is to sell some or all of the stock holdings in a portfolio and wait until the markets rise to buy stocks again. It sounds simple. The reality is much different. When selling stocks to time markets, there are two decisions to make. The first and easiest decision is when to sell. The second is when to buy again. It is very difficult to see when the next rally has started.

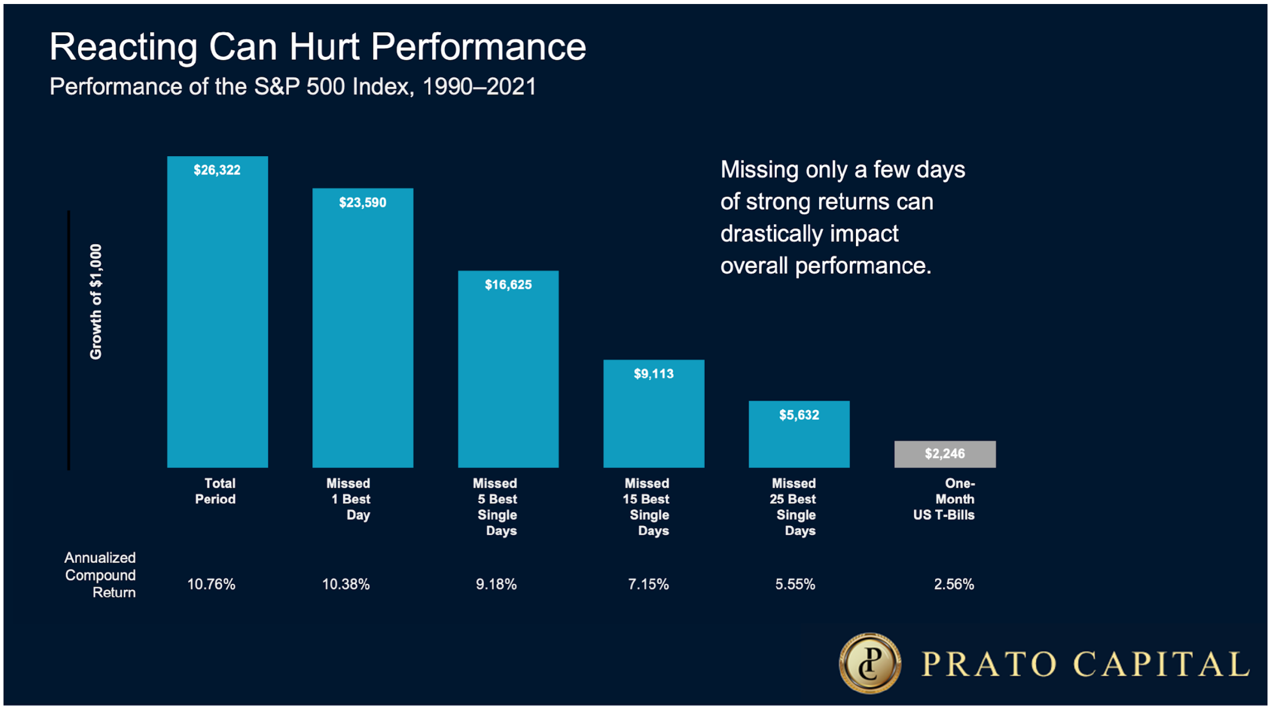
Below are some headlines from 2009 after stock markets started a bull market that would last for 11 years and gain over 500%:

- June 24, 2009: Warren Buffett to CNBC: 'U.S. Economy In "Shambles" .. No Signs of Recovery Yet'
- April 6, 2009: George Soros to Reuters: 'The U.S. economy is in for "a lasting slowdown" and won't recover this year, while "the banking system as a whole is basically insolvent"'.
- November 6, 2009: The New York Times, 'U.S. Unemployment Rate Hits 10.2%, Highest in 26 Years'[2]

By the time the New York Times had reported October 2009's unemployment report, the S&P 500 had gained over 58% since its March 2009 low. Deciding to buy stocks when the news and headlines are so negative would be very difficult.

Below is a chart showing the impact on a stock portfolio when missing just a few days of strong market rallies.

[2] Peter S. Goodman, 'U.S. Unemployment Rate Hits 10.2%, Highest in 26 Years', *The New York Times,* November 6, 2009, www.nytimes.com/2009/11/07/business/economy/07jobs.



We have also included a link below from Dimensional Fund Advisors that shows stock market returns for 1, 3, and 5 years after market declines of more than 10%, 20%, and 30%. The returns are significant and could be missed if an investor has 'cash on the sideline'.

https://www.dimensional.com/us-en/insights/history-shows-that-stock-gains-can-add-up-after-big-declines

Conclusion

In 2022, we have seen a bear market and stock volatility that has shaken many investors. The truth is that it is difficult seeing the value of a nest egg decrease. But bear markets are a normal part of investing in the stock market, just like bull markets. To reach an average of about 10% annual return, the S&P 500 will have years with greater, some with much greater returns, and some years will see returns less than 10%, like those that we are seeing this year.

The economic news of rising rates of inflation and rising interest rates are concerning. Like downturns of the past, there are always a few analysts and commentators predicting long drawn-out market declines. History has shown that stock markets do recover but those recoveries and subsequent bull markets are not announced ahead of time. Some investors will miss out while they still sit on their 'cash on the sideline' waiting for a sign. We may not see gains every year, but the S&P 500 has averaged 10% for almost 100 years and nothing is really different this time to question the long-term averages for the future.

We are always available to talk about the market, financial planning, or anything else on your mind. Please contact us anytime.

"The more you know about the past, the better prepared you are for the future."

- Theodore Roosevelt