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Do We Have a Recession?

Global Markets and Regions

	4th QTR	2018 YTD
US	-13.7%	-4.50%
Developed Europe	-12.70%	-14.30%
Asia	-11.10%	-13.50%
Emerging Markets	-7.23%	-14.97%

US Markets

	4th QTR	2018 YTD
Dow 30	-11.30%	-3.50%
Large Cap Cos.	-13.69%	-4.53%
Mid. Cap Cos.	-17.23%	-11.03%
Small Cap Cos.	-20.58%	-8.75%
Bonds	1.62%	-0.16%

Markets had a disappointing fourth quarter. What had been a modestly positive year through the first three quarters quickly turned south, delivering negative returns for the year. No asset class was spared. International returns were particularly bad. Even fixed income was negative. The last time equity returns delivered losses was 2015. The last time fixed income delivered negative returns was 2013. Rarely do both sides of the investing spectrum deliver disappointing results. This past year was one of those very rare years. What are we to take from all of this?

Generally the worst environment for equity investors is a recession. Declines in economic output result in lower sales and earnings for corporations, which translate to lower stock prices. It's not too much more complicated than that. Recessions are a normal part of the economic cycle. The average length of a recession is about nine to ten months, followed by the next expansion, which is generally much longer. We've gotten used to the expansion we've been in. Stock prices decline into the recession and advance into the recovery. The deeper the recession, the deeper the price decline. The question we face is; "do we have a recession?"

Gross domestic product growth in the US economy has been modestly positive for the last several years. Growth is expected to be around 2.5% for the 4th quarter of 2018. This is actually a bit higher than the prior several years. Forecasts are for continued growth into 2019 for the US economy. Most of the rest of the world, outside of China, has not had this kind of growth. Europe and much of the developing world are actually in recession. Their equity markets reflect this clearly. Can their poor growth results drag the US economy into recession?

The proximate cause of recessions in the US has been the Federal Reserve. Their task is to facilitate a stable monetary and credit environment to support the health of the US economy. This is a delicate mandate to execute and recessions are part of the process. Because of the severity and unique nature of the 2008 recession and financial crisis, the extraordinary strategies of Zero Interest rates and Quantitative Easing have added the need to somehow “normalize” monetary policy. This is a new development and has made things more complicated in an interconnected world economy. The job has gotten a little harder.

The two largest economies are the US and China. (The European Union is collectively larger than China but only collectively.) The US economy is still about 70% larger than China. China has been growing faster than the US, but not recently. China’s growth rate has slowed significantly and may actually be headed to recession. This would be a new development. They have been growing significantly faster than the rest of the world for a number of years as their need for resources and other goods have been a strong source of global demand. In a Globalized world economy, the relative health of all is becoming more important, particularly a major player such as China.

The current tariff standoff with China has dramatically affected China. They are at a critical point in their development as a major economic player and are not handling the transition particularly well. Their trade issues go well beyond their disputes with the US. We’re not the only economy having issues with China. Their economy is paying a severe price in this dispute and the impact is noticeable.

Markets are faced with a list of potentially transformative issues along with these global trade issues. They have reacted as if they expect the worst to transpire. The financial headlines amplify and reinforce the most pressing problems. The institutions and politicians responsible for navigating these issues don’t always seem to be up to the task. But the worst is not actually happening yet. The US consumer is still spending as the overall labor and employment situation continues to improve. Corporate earnings are still projected to increase, though at a slower rate. The US economy is still growing, even though the rest of the world is slowing down. We’re slowing down, but we haven’t stopped growing. We are still the largest and most fully integrated economy on the planet. We’ll know soon whether a recession is at hand here, but for the time being the US economy is still standing strong and has the capability to pull the rest of the world along with it. Let’s hope so.