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Recession…Are We There Yet?

Global Markets and Regions

	2nd QTR	2022 YTD
US	-16.61%	-21.10%
Developed Europe	-14.20%	-20.40%
Asia	-10.90%	-17.50%
Emerging Markets	-10.58%	-17.17%

US Markets

	2nd QTR	2022 YTD
Dow 30	-10.80%	-14.40%
Large Cap Cos.	-16.10%	-20.00%
Mid. Cap Cos.	-15.43%	-19.63%
Small Cap Cos.	-14.96%	-18.89%
Bonds	-5.02%	-10.91%

Recession is defined as a significant, persistent and widespread contraction in economic activity. It can be, at minimum, characterized as two consecutive quarters of declining Gross Domestic Product (GDP). The National Bureau of Economic Research (NBER) gets to make the official designation of the beginning and end of recessions. They make their designations after the fact. They essentially tell you what happened, not what will happen. The markets are forward looking. They try to predict the future and not always accurately.

Markets anticipate the start, the depth and the length of recessions. Recessions are bad for earnings and earnings are ultimately the key driver of stock prices. The first half of 2022, markets have made a pretty emphatic statement regarding recession. The question is… are we there yet? While economists, analysts and the NBER contemplate the data, it appears the markets have already spoken. Have markets overstated the call?

The Federal Reserve is generally a proximate cause of recessions. They also can be supportive of expansions. The credit tightening tools they use to try to control inflation result in less demand for goods and services across the economy. We're an economy that runs on credit. Their tools are essentially blunt instruments to control the availability of credit; higher interest rates and the reduced availability of loans through lowered money supply. The Fed is in now in tightening mode. Markets always pay attention to the Fed and the Fed has entered the conversation loudly and markets are listening. But the Fed is not the only culprit in causing recessions.

Inflation has roared back in a manner not seen since the 1970s. A little inflation is built into the macro-economic background. Recall how the Fed and other global central banks target 1-2% inflation as a base condition for long term economic growth. What we are experiencing is a magnitude above that target and is seriously disrupting business' ability to adjust. Inflation is too much money chasing too few goods, which is our current condition.

Inflation is also being fed by continuing supply disruptions from COVID as well as the lingering effects of government's COVID policies. The global economy was essentially shut down to fight COVID. Supply chains were turned off. Governments flooded their constituents with cash assistance to individuals, business and local governments. Post COVID supply chains have, for the most part, been "turned on" again and they are not working well. In typical fashion, governments have continued to funnel cash into constituent's hands. The cash assistance is too much money chasing too few goods.

Global governments have also chosen this moment in time to accelerate their plans for a fossil fuel free world. Not surprisingly to most people, energy prices have exploded upward. Russia deciding to start a war in Europe has, pardon the metaphor, thrown gasoline on the fire of fast rising energy problems. It seems obvious this is not the time for "Green Energy". But key governments, especially in the US, Europe and Canada are acting as if they can wave a magic wand and immediately transition to a "Green" future. High energy prices have been the number one driver of high inflation. How much pain will it take before governments acknowledge this and alter their response?

July kicks off earnings season. We will begin to see the impact of the Fed's efforts to reduce demand and slow the economy as well as the impact on earnings due to higher costs. The fact that the rest of the world's major economies are in generally worse shape than the US economy magnifies the consequences in a globalized system. Their problems are our problems and ours are theirs, particularly where energy pricing is concerned.

So, we find ourselves in a bear market the likes of which we haven't seen since 2008 -2009. The causes of bear markets are always different. Their impacts traumatize investors none the less. The COVID bear market of 2020 was one of the strangest in history. The recession that caused it was real but it was precipitated by the shutdown, as the conditions for a traditional recessionary downturn were not there at the time. Many of the consequences of that disruption are responsible for our current dilemmas.

The good news is that bear markets end and are followed by bull markets. New highs on the broad market indices are historically seen within three to five years after the bottom. Broad market indices have already given us the full bear market measure of price declines. Also, bear markets historically don't last that long, generally nine months to a year. Bull markets can go on for years and sometimes decades. If we have seen or are near the bear market bottom, then the rebuilding process should begin soon. Corporate America is all about finding new and different ways to make money and grow earnings. They adjust to new realities and move forward. It's what they do and why we invest. Let's hope they re-find their mojo quickly.

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