On The Mark

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Not All Recessions Are Created Equal

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Investors are currently grappling with the question of whether the recent rise in interest rates will lead to an economic slowdown (soft landing) or an economic recession (hard landing). While the odds of a recession by year-end are increasing, we believe it will likely be less severe than recent recessions due to the buoyancy provided by prior COVID stimulus programs as well as the strong labor market.

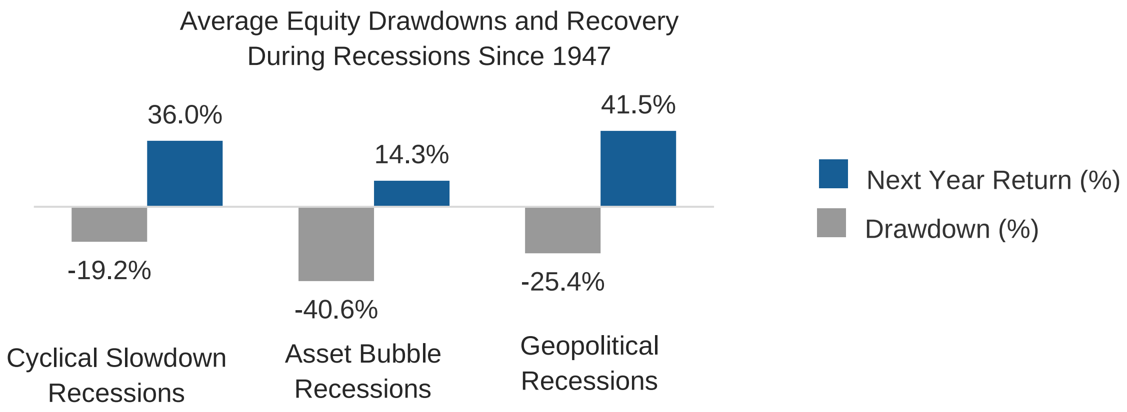
What Constitutes a Recession?

A recession is frequently defined as two consecutive quarters of negative real gross domestic product (GDP) growth. However, there are additional criteria to consider when determining whether a slowdown might actually be a recession. According to the National Bureau of Economic Research (the official arbiter of identifying recessions in the US), other criteria include declines in real income, employment rates, industrial production, retail sales, and consumer spending.

Not All Recessions Are the Same

The National Bureau of Economic Research has identified 12 recessions in the US since 1947. These recessions and recoveries have taken various shapes and sizes, but they generally fall into three categories:

- **Asset Bubble Recessions** such as the 2008 housing "bubble burst" are caused by asset prices that rapidly outpace their fundamentals, which eventually causes the bubble to burst. This can lead to financial crises and result in steep declines in equity markets.
- **Geopolitical-Driven Recessions** are based on events such as the oil embargo of 1973-1974. On average, geopolitical recessions tend to be the shortest in duration because of their event-driven nature. For example, the COVID recession, which was caused by a government-mandated shutdown of the economy, lasted only 2 months.
- **Cyclical Slowdown Recessions** can occur when there is a shift in demand and supply. This type of recession is often the least extreme compared to its peers. An analysis of the 12 US recessions since 1947 shows cyclical recessions tend to have milder drawdowns (average -19.2%) and strong recoveries (36%) in the 12 months following the end of the recession.



Source: Bloomberg and National Bureau of Economic Research.

The Bottom Line

Recessions are unavoidable. Even while the odds of a recession are increasing in 2022, a recession is unlikely to be as deep as the financial crisis in 2008 because of the CARES Act, Coronavirus Relief Act, and American Rescue Plan Act, strengthening the balance sheets of households and businesses.

The US government typically delivers fiscal stimulus during a recession to help jumpstart the economy. Most of the direct stimulus in response to the COVID recession benefitted consumers after the recession ended in April 2020 and resulted in stronger consumer and corporate balance sheets compared to previous economic cycles. While inflation is clearly reducing the strength of those balance sheets, the labor market remains incredibly strong, which may help reduce the magnitude of a potential recession.

Finally, recessions don't last forever, and neither do bear markets. Markets tend to rebound from bear markets over the subsequent 3 to 5 years, which means for most investors it makes sense to stick to their long-term investment plans.

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