Investing Insights

why stay invested during a recession?

What Exactly is a Recession?

The National Bureau of Economic Research (NBER) defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators. NBER identifies a month when the economy reached a peak of activity and a later month when the economy reached a trough (bottom). The time in between is a recession, a period when economic activity is contracting. It's important to recognize that a recession, the way we use the word, is a period of *diminishing* economic activity rather than *diminished* economic activity.

A recession is defined by economic data, not market data. Markets move much faster than the economy and see early indications that things are improving – this is reflected in earnings estimates, valuations, and other variables that bring investors back to investing, primarily institutions first. Retail investors slowly gain confidence as the markets go up, they start investing little by little, causing markets to go up further which over time encourages consumers to start spending and employers to start hiring, all of which pumps life back into the economy. Simply put, investors don't feel better until the markets go up and investors determine, based on their behaviors, the state of the economy.

Looking back at past recessions shows us that the stock market typically posts a gain during a recession. For example, during the 16 months of recession from July 1981 to November 1982, the S&P 500 posted a 14% total return. Another recession followed the late 1980s and early 1990s Savings & Loan crisis, during which more than 1,000 U.S. financial institutions failed, primarily as a result of imprudent real estate lending. During this eight month recession, from July 1990 to March 1991, the S&P 500 generated an 8% total return.

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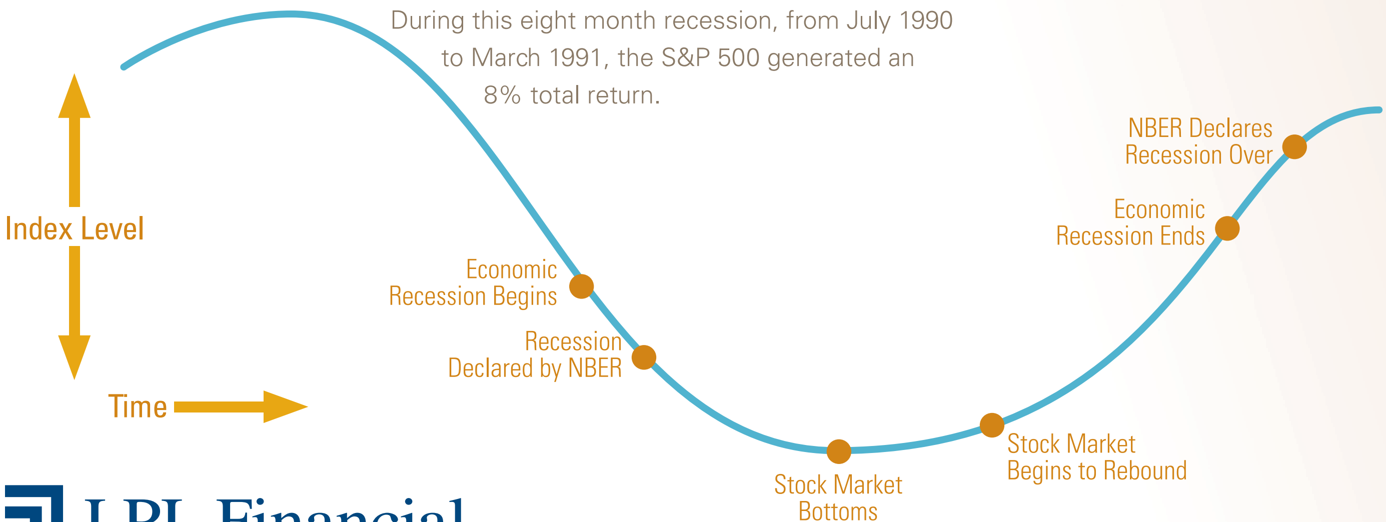

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bouncing back

The table below shows the S&P 500 performance during past recessions, the overall length of the recession and total decline of the markets over that period. It also illustrates the number of months it took for the market to spring back from the bottom to the end of the recession and what the gains along that journey were. As you can see, stocks have always bottomed before the recession was over—typically around the halfway point—and delivered on average powerful 25% gains, recouping nearly all losses by the end of the recession.

The Springboard

Early drivers triggering a rebound are typically fiscal or monetary policy actions. Past examples:

- In October of 1990, after a tripling of oil prices due to Iraq's invasion of Kuwait, oil prices finally began to recede as stepped up production by OPEC and non-OPEC members ensured oil supplies remained sufficient. The Fed also began to cut rates aggressively starting in October of 1990. These factors marked the turning point for the 1990 bear market.
- An FDIC takeover and the Fed rate cuts that followed one of the largest bank failures in history helped to end the long November 1980-August 1982 bear market.
- The Fed cut rates substantially beginning in March of 1980 ending the market decline, as inflation finally began to fall after peaking in that month at a 14.8% year-over-year pace, reversing a series of rate hikes that had taken the fed funds rate to 20%.
- Fed rate cuts of 375 basis points helped to put a close to the 1973-74 bear market. The cuts coincided with the October 1974 failure of Franklin National Bank, which was at that point the biggest bank failure of all time. Closure of the issues surrounding Watergate also helped this recovery.

S&P 500 PERFORMANCE DURING PAST RECESSIONS

Peak	Bottom	Total Decline	Length of Recession in Months	Months to spring back from Bottom to End of Recession	Gain from Bottom to End of Recession
06/15/48	06/13/49	-21%	11	5	+18%
02/02/53	09/14/53	-14%	10	9	+28%
07/15/57	10/22/57	-21%	8	6	+11%
08/03/59	10/25/60	-14%	10	4	+21%
11/29/68	05/26/70	-36%	11	6	+26%
01/11/73	10/3/74	-48%	14	6	+34%
02/13/80	03/27/80	-17%	6	4	+24%
11/28/80	08/12/82	-27%	16	4	+35%
07/16/90	10/11/90	-20%	8	6	+29%
03/24/00	10/09/02*	-49%*	8	*	*
Average ex-2002		**-24%**	**10**	**5**	**25%**
10/09/07	Current	-30%			

Source: Bloomberg and the National Bureau of Economic Research, LPL Financial Research

* This recession ended in November of 2001—from the low point during the recession (9/21/01) until the end of the recession stocks were up 18%—but stocks fell again in late spring of 2002 as accounting scandals renewed the market decline, culminating in a 49% total decline for the entire two and one-half year bear market.

Don't let your emotions make your investment decisions, these can be intimidating times. Plan long-term and consider historical performance. Talk to your financial advisor and stick to the plans you make together to help you reach your financial goals.

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