Richard Bernstein Advisors
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RBA Quick Insights

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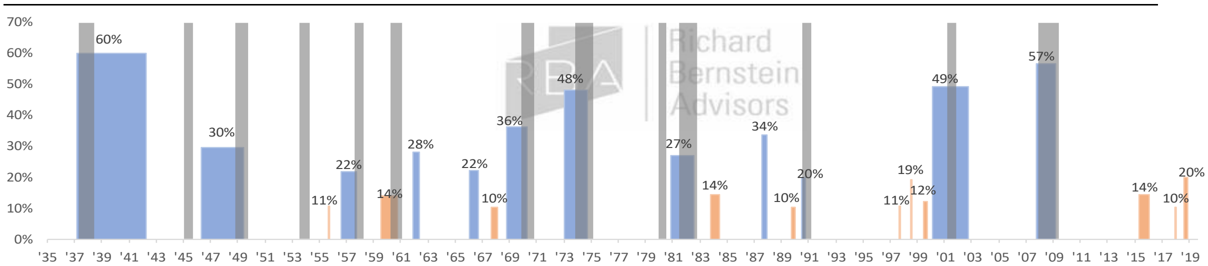
Recession, recession, recession!

In an iconic episode of The Brady Bunch, that originally aired in 1971 (*Her Sister's Shadow*), middle sister Jan throws a jealous tantrum over being overshadowed by oldest sister Marcia: "Well all I hear all day long at school is how great Marcia is at this or how wonderful Marcia is at that…Marcia, Marcia, Marcia!" These days, all I hear all day long on the business networks is how the markets will go up because a recession is unlikely or that a bear market is coming because a recession is near…recession, recession, recession!

While an economic recession would not be good for stock markets, we think investors are obsessed with the wrong kind of recession. We've had several recessions not accompanied by bear markets (1945, 1953, 1960 and 1980) and several bear markets not accompanied by recessions (1962, 1966 and 1987). The chart below shows all the official recessions (grey shading) since 1935 along with all the US bear markets (blue bars) and 10%+ corrections (orange bars). There is clearly a relationship, but it's far from consistent.

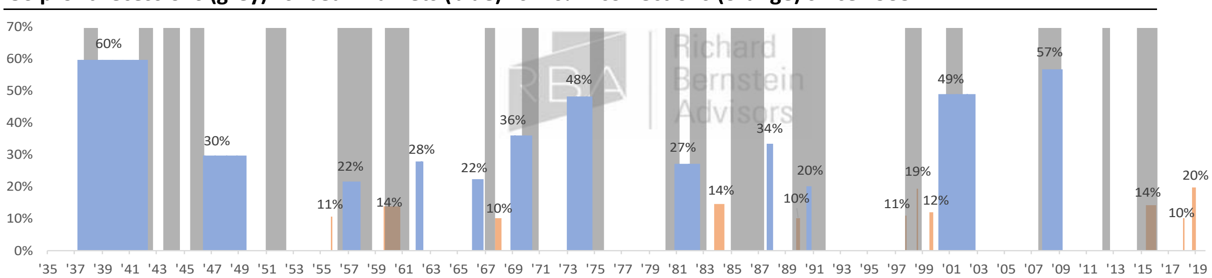
US economic recessions (grey) vs. bear markets (blue) vs. 10%+ corrections (orange) since 1935



Source: Richard Bernstein Advisors LLC, Bloomberg, NBER.
Grey shading: US recessions; Blue bars: bear markets; Orange bars: non-bear market 10%+ corrections (magnitude denotes peak to trough market decline).

Now look at what happens when we replace economic recessions with profit recessions in the grey shading. Profit recessions and bear markets are not one-for-one either (mostly because of the role that sentiment and liquidity play), but they do seem to line up much better than in the first chart, and — critically — with more lead time. In fact, **you've never had a bear market that didn't occur within six months of a profit recession**, and until this cycle, you've never even had a 10%+ correction that didn't occur within seven months of a profit recession! This is a great illustration of why we focus on profit cycles instead of economic cycles. At RBA, we see a better than even chance of a profit recession in the coming quarters alongside indications of shrinking liquidity. That's generally not a good sign for markets, regardless of whether we enter an 'official' recession.

US profit recessions (grey) vs. bear markets (blue) vs. 10%+ corrections (orange) since 1935



Source: Richard Bernstein Advisors LLC, Bloomberg, S&P.
Grey shading: US profit recessions; Blue bars: bear markets; Orange bars: non-bear market 10%+ corrections (magnitude denotes peak to trough market decline). Profit recessions defined here as peak to trough trailing 12-month S&P 500 GAAP EPS declines where annual growth rate turned negative.

Let's pretend that you were an investor in the 1940s and you sold all your stocks because you correctly predicted the 1945 recession. Too bad for you because the US stock market returned 36% that year. Then let's say that once the recession ended in November 1945 you correctly predicted that there wouldn't be another recession for three years, so you decided to put all your money into the stock market. Well too bad again because the market peaked half a year later in May 1946 and didn't find a bottom until three years later by which time the market had fallen 30%.

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