SPECIAL UPDATE

Recession Fears Overblown

Special commentary for February 17, 2016

"One day it started raining, and it didn't quit for four months."
— Forrest Gump

The market has equated falling oil prices with fear. Many headlines have rotated on the cover of national publications — China, Fed policy, strong dollar — but this equity market selloff has very little to do with any of that. For some time, it has been all about the price of oil. The frustrating part for investors, besides the S&P drawing down 13.2% from recent highs, is discerning what will come next. Can stocks fall into bear market territory without a recession? Historically, bear markets (often defined as a peak to trough decline of 20% or more) have been accompanied by recessions, but there is precedent for having steep equity declines without recessions. Most recently, in the summer of 2011, the S&P 500 fell 21.5% peak to trough during intraday trading. This was not technically classified as a bear market, because using closing prices it "only" fell 19.4%. The point being, bear markets can occur without recessions.

If you look at past recessions relative to present, there are many stark differences. The most common thread that accompanies deep recessions is a U.S. consumer that is struggling to make ends meet. Take a look at recessions over the past 50 years:

- **2008:** GDP -4.3% peak to trough. The consumer was adversely effected, the most important asset for any consumer is their house.
- **2000:** GDP -0.3% peak to trough. It was a shallow recession as the dot-com bubble had little effect on consumer.
- **1990:** GDP -1.4% peak to trough. Price of oil doubled along with aggressive Fed tightening. The greatest U.S. bull market of all time followed.
- **1981:** GDP -2.7% peak to trough. Inflation soared to 13.5%, oil prices doubled, and the Fed took rates to 14%.
- **1974:** GDP -3.2% peak to trough. Price of oil increased four fold, post-Vietnam stagflation caused 9% unemployment and 11% inflation.
- **2016:** GDP forecast of 2.4%. Very little inflation, oil down 75%, and the Federal Funds rate at 0.25%.

To summarize, it is hard to envision a recession as these are not recessionary conditions. Recessions do not start with consumer confidence at record highs, clean household balance sheets, gas prices below $2 a gallon, and unemployment at 4.9%. Additionally, the quit rate (employees voluntarily leaving their jobs) is at cycle highs. Generally people quit their jobs when they're confident about future employment prospects, not when they're nervous about making car payments or mortgage payments.

In our view, there is a dislocation between financial market prices and economic realities. There is no formula for the market we are facing, which is what makes the activity so interesting to watch. Sentiment has taken a hit and investors seem to be forecasting a higher probability of U.S. or global recession. We do not believe conditions are in place for a recession in the United States. The U.S. has experienced a moderate economic expansion, and that should continue. We expect positive developments to occur over the coming months. When it does become more evident that the economy remains on track, improved performance in equity markets should follow suit.

"And then, just like that, somebody turned off the rain and the sun came out."

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