INVESTMENT FUNDAMENTALS

What is a Recession?

FEBRUARY 2019

Snapshot

- A recession is loosely defined as a significant decrease in economic activity that lasts for more than six months.
- Recessions occur during the contraction phase of the business cycle and are usually caused by higher-than-necessary inflation.
- Bear markets (or declines of 20% or more in a broad stock market index such as the S&P 500 Index) typically accompany recessions.

Economic recessions, while widely dreaded, are about as commonplace as hairline recessions (also widely dreaded). But unlike receding hairlines, receding economies eventually return to growth. Loosely defined as a significant decrease in economic activity that lasts for more than six months, recessions are simply a normal part of the business cycle.

According to the National Bureau of Economic Research, a recession officially begins after two consecutive quarters of negative real (inflation-adjusted) gross domestic product (GDP) readings—which measure the value of all finished goods and services produced in a country.

But many experts also say that recessions can start under the radar, between quarterly GDP reports. In order to determine whether the economy is headed for or already in a recession, economists look to two types of data: leading and lagging indicators.

Leading indicators represent areas of the economy that typically change course, with either accelerating or decelerating growth, before the majority of the economy begins to follow. These indicators are thought to foreshadow significant impending changes in the economy. Examples of leading indicators include the U.S. Department of Labor's jobless claims report, the Conference Board's consumer confidence index and the Institute for Supply Management's purchasing managers' index.

Lagging indicators are areas of the economy that tend to change course only after the majority of the economy has started moving in a particular direction. Examples of lagging indicators include the Federal Reserve's benchmark interest rate, the U.S. Department of Labor's consumer price index, and the U.S. Department of Commerce Bureau of Economic Analysis' gross domestic product and trade-balance data.

When and Why Do Recessions Happen?

In the U.S., a full business cycle runs for an average of 4.7 years and consists of four distinct phases: expansion, peak, contraction and trough.

Recessions occur during the contraction phase of the business cycle. There have been 14 recessions in the U.S. economy since 1929 (Exhibit 1). The average recession lasts for about 18 months—as 2007's Great Recession, the most recent one at the time of this writing, did.

Exhibit 1: U.S. Recessions Since 1929

Recession	GDP Contraction	Duration	Time Until Next Recession
August 1929–March 1933	-26.7%	42 months	50 months
May 1937–June 1938	-18.2%	13 months	80 months
February 1945–October 1945	-12.7%	8 months	37 months
November 1948–October 1949	-1.7%	11 months	45 months
July 1953–May 1954	-2.6%	10 months	39 months
August 1957–April 1958	-3.7%	8 months	24 months
April 1960–February 1961	-1.6%	10 months	106 months
December 1969–November 1970	-0.6%	11 months	36 months
November 1973–March 1975	-3.2%	16 months	58 months
January 1980–July 1980	-2.2%	6 months	12 months
July 1981–November 1982	-2.7%	16 months	92 months
July 1990–March 1991	-1.4%	8 months	120 months
March 2001–November 2001	-0.3%	8 months	73 months
December 2007–June 2009	-4.3%	18 months	???

Source: National Bureau of Economic Research

Most economists believe that higher-than-necessary inflation is the primary cause of recession. As inflation rises, consumers generally reduce their spending in favor of saving money. A downshift in consumer spending, which drives over two-thirds of the economy, can have a ripple effect on businesses. When consumer demand dwindles, industrial production follows suit, leading to layoffs. Income falls, unemployment spikes and the economy enters a contraction phase.

In addition, unexpected shocks, such as banking crises or a significant jump in oil prices, may send the economy into a recession. The deflation of an economic bubble—which is caused by a rapid escalation of asset prices followed by a contraction—may also lead to a recession.

Tough Times Don't Last

Recessions are a painful, but normal, part of the business cycle. Bear markets—declines of at least 20% in a broad stock market index such as the S&P 500 Index—typically accompany recessions (but not all bear markets are accompanied by recessions).

In general, selling out of stocks when a recession begins runs counter to one of the basic premises of investing, which is to buy low and sell high. Many investors who pulled out of stocks during the Great Recession regretted it later—not just because of the loss they incurred by selling at lower prices, but also because many missed out on the rebound once the market began to recover.

Index Definitions

The S&P 500 Index is a capitalization-weighted index made up of 500 widely held large-cap U.S. stocks.

Important Information

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice. This information is for educational purposes only and should not be interpreted as legal opinion or advice.

There are risks involved with investing, including loss of principal. Diversification may not protect against market risk.

Information provided by SEI Investments Management Corporation, a wholly owned subsidiary of SEI Investments Company. Neither SEI nor its subsidiaries is affiliated with your financial advisor.

190205.02 IMU (02/19)