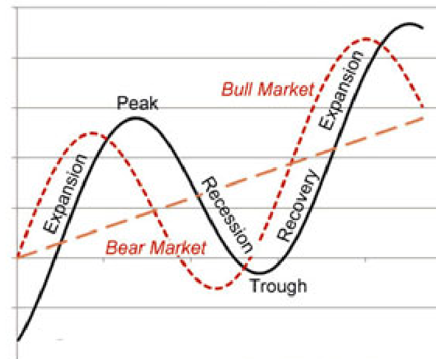
A Publication of Brian Carruthers & Associates
Third Quarter 2016

# Waiting for the Recession




*Recession - a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in GDP in two successive quarters.*

When it comes to investing, recessions matter. They matter a great deal. Major stock market declines have occurred during recessions. When recessions start with stocks at high valuations, the largest declines have followed. The best market performance has historically occurred in 1, 3 and 5 years following the end of a recession. There are exceptions to the outperformance, but they are the outliers.

In a normal business cycle, recessions occur on average every five years. It's part of the cyclical nature of life. We tend to swing from one extreme to the other and in the process, maintain a relative balance. The longest time the U.S. economy has gone without a recession is 10 years.
The United States went through its longest, and by most measures worst economic recession since the Great Depression between December 2007 and June 2009. Since then the recovery in terms of Gross Domestic Product (GDP), has been one of the weakest on record with average annual GDP growth of only 2.1%. First quarter 2016 came in at an anemic 0.8% annual rate.

And that presents the investor with a dilemma. The current recovery is seven years old. It's nearing nine years since the start of the recession. History tells us a recession may well be overdue. At the same time, stock market valuations are definitely on the high side. Using Yale professor and Nobel laureate Robert Shiller's 10-year average of "real" (inflation-adjusted) earnings, the historic P/E10 average is 16.7. In February 2015, the ratio hit a new interim high of 27.0, before receding to 24.3 at the end of May.

Is the U.S. on the verge of a recession, in a recession or continuing a struggling recovery? Ironically, we will only know in hindsight. One of the best recession indicators has been an inverted yield curve when short-term interest rates exceed long-term rates. But the Fed's manipulation of interest rates over the last seven years has depressed short-term rates to well under 1%, sidelining the inverted yield curve's validity. Even when interest rates reflected actual market demand, economists at the National Bureau of Economic Research have been six to 12 months late in detecting a recession.

What we do know is that recessions are part of the normal business cycle. Government intervention may delay their onset, but this has its dangers. "Stability leads to instability. The more stable things become and the longer things are stable, the more unstable they will be when the crisis hits," said American economist Hyman Minsky. We also know that

the stock market is well above average valuations, a precursor for above average losses.

Which brings us back to another great truth of investing - "Markets can remain irrational a lot longer than you and I can remain solvent," attributed to John Maynard Keynes.  As students of the financial markets, we strive to understand and anticipate the market's trend, but not predict. We let the market tell us when it's time to move. This is not; however, the time to decide a passive index strategy is the way to invest.

Brian R. Carruthers, CFP®, CMT

Brian R. Carruthers & Associates
Your Conservative Advisory Firm Since 1990
301 Forest Avenue
Laguna Beach, California 92651-2115 USA

Telephone: 1-949-464-1900
www.gobcafunds.com
brian@gobcafunds.com



***STAY CONNECTED***

Brian Carruthers & Associates, 301 Forest Avenue, Laguna Beach, CA 92651

SafeUnsubscribe™ {recipient's email}

Forward this email | Update Profile | About our service provider

Sent by brian@gobcafunds.com in collaboration with

Try it free today