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Investment Focus

Estate Planning

What is the Economic Path Forward?

It may be difficult to remember, but it was only months ago that we were in the midst of the longest economic expansion in history. How quickly things have changed. As a result, many investors are asking: what is the economic path forward?

Beyond the terrible health consequences of the pandemic, the short-term economic effects have been equally extraordinary. We have seen individuals, companies and industries affected in adverse ways. COVID-19 has also helped to accelerate certain existing economic and political trends: increasing automation, greater scrutiny of foreign direct investment, nationalism and the evaluation of domestic supply chains. It has also magnified continuing U.S.-China trade tensions.

In the short term, we are likely to expect deflationary pressures due to reduced spending and consumption, as well as a weaker housing market, as economies begin to return to a more "normal" state. While certain media voices raised the potential for an economic depression when projecting unemployment levels and economic growth declines, these historic troubles were likely compounded by a series of poor policy decisions, unlike today.[1]

What is a Trillion? Unprecedented Stimulus...

We must not overlook the unprecedented support by global policy-makers in trying to minimize the implications of the crisis. Consider the U.S., where lawmakers have passed trillions of dollars in stimulus relief. To put the magnitude of one trillion into context, if we were to travel back in time by a billion seconds, we would be in 1989. However to go back a trillion seconds would take us to around 30,000 B.C.

Many central banks have engaged in quantitative easing (QE), which is a form of monetary policy, by purchasing financial assets to inject money into economies. The Bank of Canada began its first-ever move into QE in April by purchasing $1 billion of government bonds. Alongside record-setting fiscal policy spending, increases in the money supply have not only helped to support asset prices, but also economies. For some economists, this is one reason to remain optimistic about the rate and sustainability of recovery. Of course, there will be new challenges as a result of significant deficits and debt. There are also questions as to whether these efforts will be enough to help economies quickly recover.

However, economies naturally go through cycles and the speed of recovery from economic downturns has increased over time. Recessions occur when economic output declines after a period of growth. Our economy has spent less time in recession as technology has transformed it to be more service-based, and also due to increased central bank intervention.[2] A century ago, the economy was in recession nearly 40 percent of the time; today this is less than 10 percent.

Percentage of Time in Recession — US Economy[3]

While the longer-term implications are less clear, let's not forget that after the 2008/09 financial crisis, many economists worried about high rates of inflation and slower economic growth, both of which generally did not happen.[4] Instead we participated in one of the longest economic expansions of all time.

Throughout history, economies have continued to advance and progress. Despite the challenges ahead, there may be positive reasons to continue looking forward and maintain a longer-term perspective.

1. http://hbr.org/2020/05/the-u-s-is-not-headed-toward-a-new-great-depression?ab=hero-main-text; 2. https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Commentary_366_0.pdf; 3. The rate is similar in Canada but economic data prior to 1930 isn't readily available; https://nber.org/cycles.html; 4. Inflation rates did exceed central bank targets in 2011.

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What Happens After a Bear Market?

We have encountered many new situations in response to COVID-19 — isolation, physical distancing, economic closures globally, and others — that have created uncertainties for the short term. Doomsayers cite these factors, and others, to suggest that this time is different and the current economic downturn will somehow last forever. However, economic cycles go up as well as down.

Equity markets are also cyclical. Bear markets happen from time to time. Yet, even in the worst situations, equity markets have eventually turned their course. The worst bear markets in history have seen drawdowns of over -86 percent (1932) and -56 percent (2007). Yet, the average returns following some of the worst bear markets were 53 percent, 78 percent and 143 percent over the ensuing one, three, and five year periods, respectively. Although the positive returns came after the depths of the bear markets, history reminds us that time can heal even the worst market declines.

Nobody knows the direction of the equity markets over the near term, but the long-term trend has been up. In preparation, a disciplined approach emphasizing quality, diversification and a solid plan are expected to continue to serve us well over the longer term.

Forward Returns Following History's Worst Bear Markets, S&P 500

Peak	Trough	Drawdown	1 Year	3 Years	5 Years
1929, SEP	1932, JUN	-86.2%	162.9%	170.5%	344.8%
1937, MAR	1938, MAR	-54.5%	35.2%	38.2%	84.5%
1968, NOV	1970, MAY	-36.1%	34.8%	50.6%	42.2%
1973, JAN	1974, OCT	-48.2%	38.1%	72.7%	117.5%
1987, AUG	1987, DEC	-33.5%	23.2%	55.5%	121.7%
2000, MAR	2002, OCT	-49.1%	24.4%	59.0%	105.1%
2007, OCT	2009, MAR	-56.8%	53.6%	98.0%	181.6%

Source: fortune.com/2020/03/19/coronavirus-stock-market-predictions-bear-market-stocks-bottom-what-to-expect/

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