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INVESTMENT UPDATE: INVESTING THROUGH RECESSIONS

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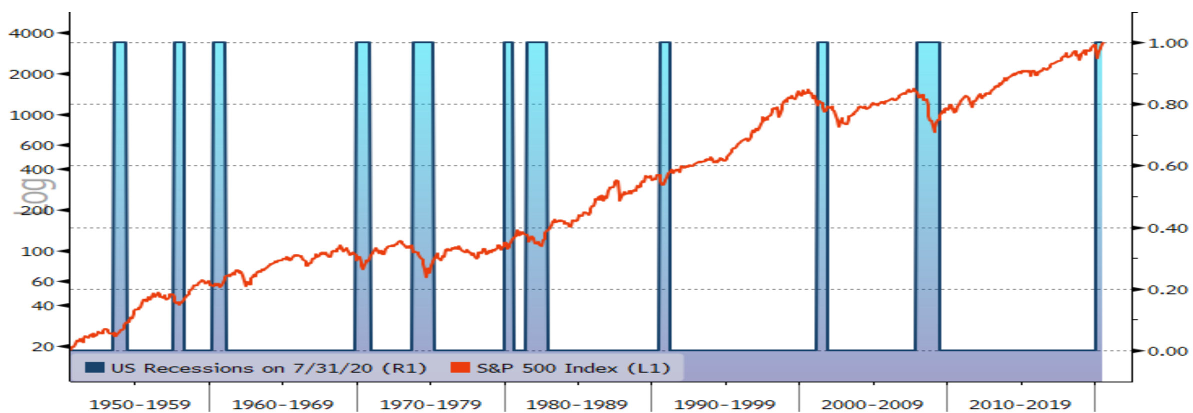
The UK's newspapers have recently been filled with headlines flagging the economy's decent into recession. Recession – in which a country's economic output falls – are typically associated with rising unemployment, business closures and a decline in long-term investment. In short, economic recessions have few – if any – redeeming features. To be clear, the UK is not alone in this: the US, Europe, Japan, and even China's mighty economic growth engine have all contracted in recent months.

It is understandable that, in the midst of a global recession, you may be concerned about your investments. While you might expect stocks to fall throughout a recession, this is typically not the case. Historically, stock markets begin to fall before a recession arrives, and subsequently rise for a protracted period, beginning in the middle of the recession, before the economy has returned to growth (see Figure 1). This certainly fits the pattern of events over the past few months.

Figure 1: The US stock market has typically bounced in – not after – US economic recessions



Source: Bloomberg

Using the S&P 500 index of the US stock market (the index for which the longest and most detailed figures are available), we calculate that the average annual return (excluding the distribution of profits to shareholders, known as dividends) since 1950 has been 7.7%. Interestingly, we find that, had investors regularly invested at the start, in the middle, or at the end of the ten recessions included in this period, their subsequent average ten-year return would have been better in all cases (see Figure 2). While an additional 1% a year may not seem much, it is enough to turn a £1,000 investment into £2,303 over ten years, £203 more than the £2,100 that the long-term average would deliver.

Figure 2: Stock market investors have historically earned above average returns when buying in the midst of recessions

S&P 500 Index	Long-Term Avg. Ann. Return			
Buy & Hold	7.73%			
S&P 500 Index	Avg. Ann. 1y Return	Avg. Ann. 3y Return	Avg. Ann. 5y Return	Avg. Ann. 10y Return
Buy at start of Recession	-1.19%	4.20%	6.38%	8.25%
Buy 3m into Recession	7.68%	5.96%	8.27%	8.95%
Buy 6m into Recession	15.10%	7.33%	10.07%	8.62%
Buy When Recession Ends	12.40%	6.03%	9.03%	8.82%

Source: Bloomberg, Omnis Investments

History therefore suggests that adding to shares in a recession is typically a rewarding strategy. We believe this is not as counterintuitive as it might at first seem. Shares, to some extent, are investments for optimists: their price should rise if the underlying companies do better than most people think they will. As the outlook is likely to be fairly downbeat in the midst of a recession, it may be rational – and profitable – to look to brighter times ahead and invest accordingly. Indeed, this explains why stock markets typically begin to recover before the recession has officially ended, but perhaps once an end is in sight.

So where does this leave us now? In some respects, the 'current' recession is like none that has ever been seen before. In the first place, it was voluntary – an accepted consequence of lockdown which was designed to limit the human cost of the coronavirus. In the second place, we have known about it almost from the day it started. Though a somewhat technical point, it normally takes several quarters to confirm that an economy has shrunk, and to pinpoint the date the contraction began (by way of example, though the US entered recession in December 2007 as the Great Financial Crisis took hold, this was not officially confirmed until December 2008). This unusual clarity is equally applicable as we look towards the recession's end. Indeed, absent a return to strict lockdown conditions, recent economic figures have made it clear that we have probably already emerged from the 'current' recession.

In this light, the sharp stock market falls in March and the remarkable recovery since are both perhaps understandable. While the gains made over the past five months or so suggest that the very best time for investing in this recession may have passed, we do not believe this fundamentally alters the conclusion we draw from our historic analysis – that investing in shares in and around economic recessions, in conditions similar to those that surround us today, is more often than not a profitable endeavour for long-term investors.

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