STATERA
ASSET MANAGEMENT

Commentary: October 2019

RECESS[ION] BELL

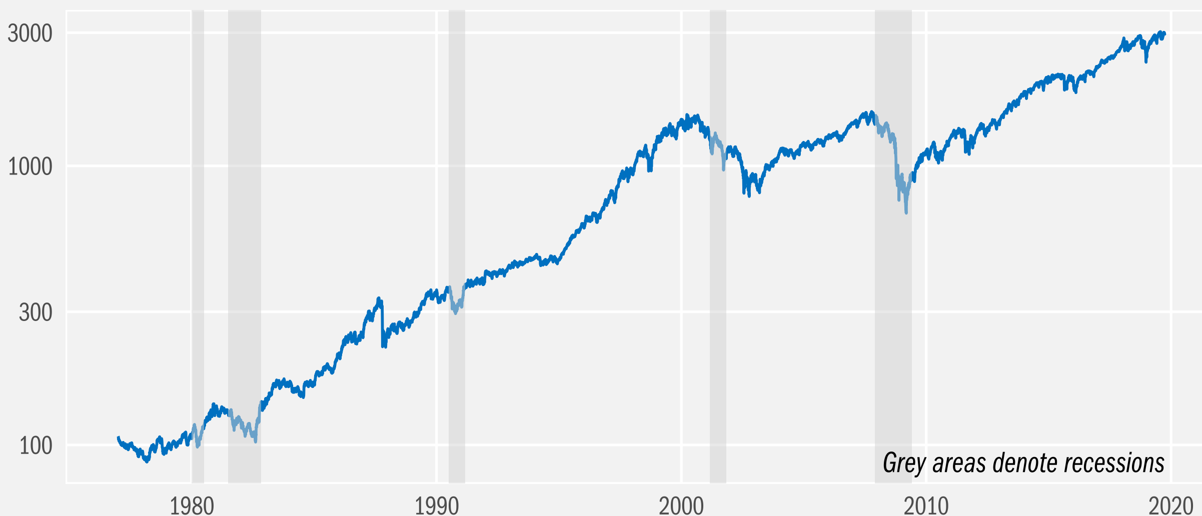
Seems like each day brings a new call that a recession is right around the corner. Or, if not right around the corner, somewhere in the nearer-term future. If not so soon, then likely at some point over the next few years. Or perhaps later. Of course, one of those statements must be true. As always, the timing of that recession is up to the universe to decide. And where timing is considered, we generally caution against shifting target portfolio exposures in light of any "pending" recession. We find the most defensible approach is one that sticks to target allocation that accommodates comfort with the potential market-related ramifications of macroeconomic downturns, while remaining focused on longer-term plans.

When Don't We Worry?

The current expansion has run for more than a decade. Despite the lack of a firm yardstick, many find the duration too long and suggest a market downturn is coming. That concern might perhaps be supported by continued geopolitical and other pressures on global macroeconomic growth. Thing is, we have heard (and admittedly held) similar concerns for just about the entire length of this recovery. Figure 1 shows how much the U.S. equity market has gained despite such fears, showing in yet another way how hard it can be to time market moves, both short- and long-term.

Figure 1: S&P 500 Index

Neither the beginning, not the ending of recessions clearly align with market moves each might be seen as warranting. The accuracy of market timing decisions related to recessions is further challenged by the general delay in the identification of recessionary periods.



From 12.31.76 to 09.30.19. Price data that do not take into account the receipt or reinvestment of dividends. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

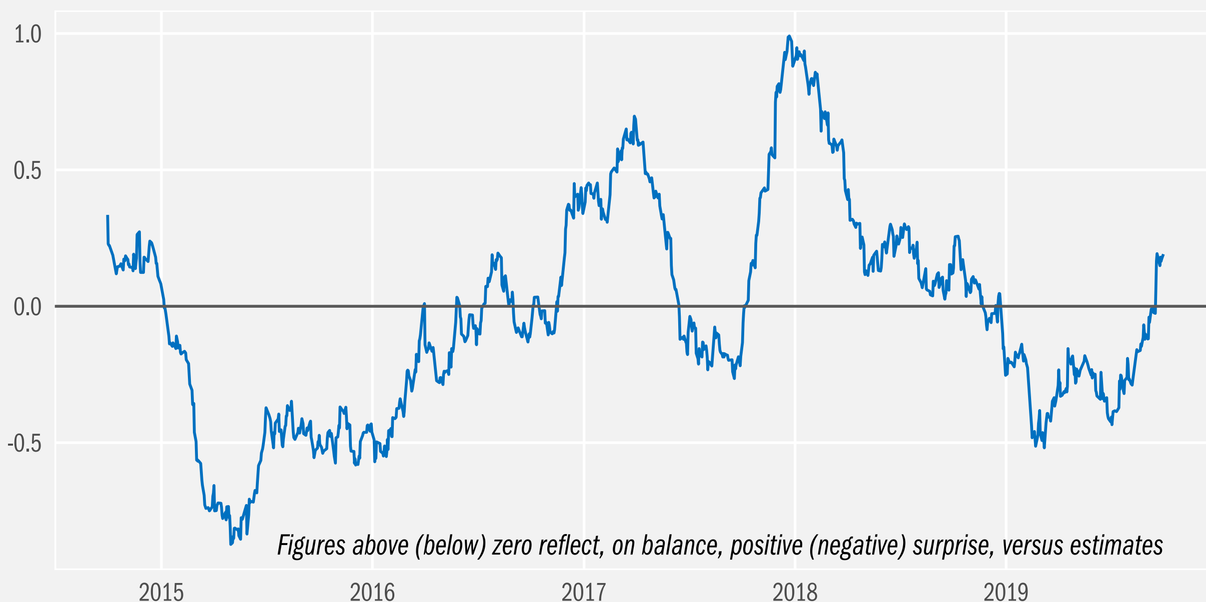
Delayed Notice

Discernable in Figure 1, it would seem the market has tended to move downward or at least flattened before the start of a recession. That's likely in no small part related to the lag with which macroeconomic data used to determine recessions are reported. Officially charged with declaring definitions, the National Bureau of Economic research utilizes a range of economic indicators in declaring a recessionary period. Such determinations are based on, "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real (gross domestic product) GDP, real income, employment, industrial production and wholesale-retail sales." Some of those data, employment for example, are released on a more regular basis, and others, including GDP data released less often. All are subject to revision, confounding any near-term determination of the magnitude and pace of macroeconomic change. Actual declarations of recessions can come many months later.

We might like to be careful then, acting on our macroeconomic anxiety; our fears may be undue. Indeed, as we see in Figure 2, even now pessimism regarding the economy may have become too grand. The chart shows a gauge calculated by Bloomberg that reflects how accurate analyst economic estimates have been. While the levels aren't expressed in the data (e.g., there is no relationship between the chart and actual levels and trends in macroeconomic activity), upward changes suggest analysts have been too cautious in their estimates, while downward shifts suggest the opposite. With concerns having loomed large, the recent upward trend in the series may come as some manner of relief.

Figure 2: Bloomberg ECO U.S. Surprise Index

The Bloomberg ECO Surprise Index shows the degree to which economic analysts under- or over-estimate the trends in the business cycle. The surprise element is defined as the percentage (or percentage point) difference between analyst forecasts and the published value of economic data releases.



From 09.30.14 to 09.30.19. SOURCE: SRCM using data from Bloomberg

Still, Clarity Lacking

As we hinted, though, recent upside to estimates for weaker growth doesn't warrant ignorance of persistent macroeconomic challenges. Though preparations continue to be made against such an outcome, the United Kingdom seems bent on a course toward falling out of the European Union without having implemented sufficient rule or treaty to replace the structures lost. Meantime, global trade has faltered further against the weight of no progress in sealing the U.S./China fracture. Likely in no small part due to mounting pressures on the global trade front, a just-released and closely watched U.S. manufacturing survey reflects a sector moving as slowly as it has in a decade. A services sector survey followed suite.

Even so, we will respeak the notion that the world near always is in some manner of pain with regard to politics and the economy. The question for readers is, given expectations for any potential market response to crisis, how comfortable are you in maintaining exposure to investment risk? We know that the answers to those questions vary by reader and for each reader over time. A financial advisor can assist in determining where the limits of that comfort may be and can seek to resolve any gaps between those levels of comfort and present exposures within an investment portfolio.

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The Bloomberg ECO Surprise Index shows the degree to which economic analysts under- or over-estimate the trends in the business cycle. The surprise element is defined as the percentage (or percentage point) difference between analyst forecasts and the published value of economic data releases. The analyst forecasts are surveyed by Bloomberg News. The surprise elements of regularly reported weekly and monthly economic data releases are smoothed over a six-month period, with more weight given to recent releases. The surprise elements are normalized and then aggregated, with the aggregated index normalized once again. The values of the ESI are therefore Z-scores, which represent the number of standard deviations that analyst expectations lie above or below normal surprise levels. This includes economic indicators, their latest values, and the short-term and long-term relationship between economic surprises and asset prices.

The S&P 500 Index measures the performance of the large-cap segment of the U.S. equity market.

One cannot invest directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.

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