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April 12, 2022

Macro Alert
An Investor's Guide to the Runup to Recession

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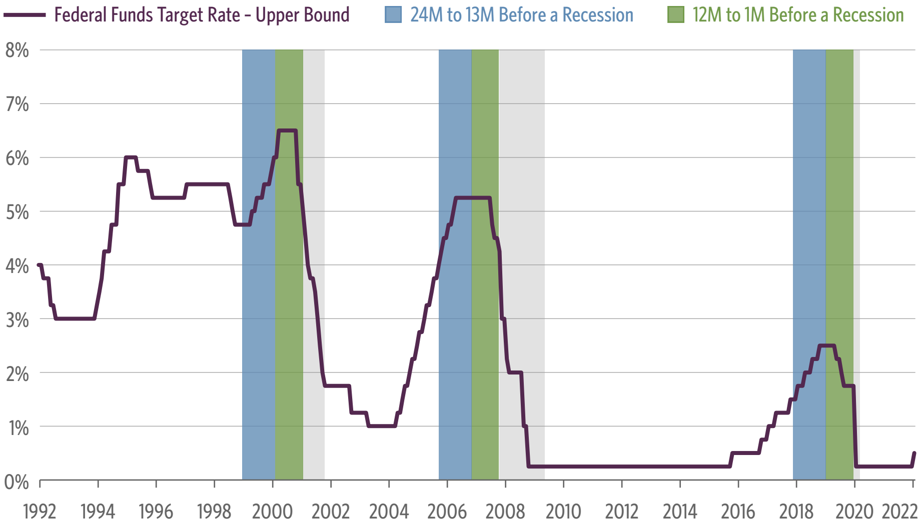
As the Federal Reserve (Fed) ratchets up its hawkishness—both in Fedspeak and in the latest minutes—the resulting market volatility and bouts of yield curve inversion show investors are discounting tighter and tighter financial conditions. The Fed has only just begun a hiking cycle and is contemplating shrinking its balance sheet as soon as May. The Fed's policy, in its simplest formulation, is designed to slow down the economy, even to the point of recession, to try to tame inflation. The economy is still growing vigorously and the execution of Fed policy has yet to fully unfold, so fears of an imminent recession are overblown. But it is not too early to think about how different asset classes and market sectors perform in the period leading up to a recession.

Examining the 24 Months Before a Recession

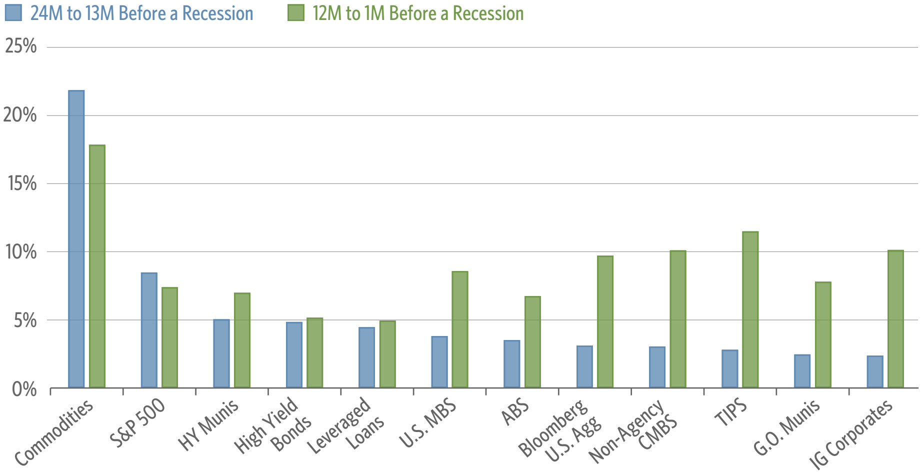


Source: Guggenheim Investments, Bloomberg. This chart examines the 24 months prior to the last three recessions with start dates of 3.31.2001, 12.31.2007, and 2.29.2020, respectively. Gray areas represent recession.

With this in mind, we compared the average performance of multiple asset classes—equities, credit, government assets—over the 24 months leading up to three previous recessions. We divided the two-year pre-recession period into the first 12 months and the second 12 months. We can also think about these periods as the penultimate and the final year of expansion.

The conclusion is quite straightforward: Riskier assets have tended to perform well when the expansion is still in its penultimate year because this period, which historically overlaps a Fed hiking cycle, takes place when growth is strong. Strong growth means healthy corporate earnings, a stable labor market, low corporate defaults and bankruptcies, all of which support the performance of equities and high yield credit. However, by the final 12 months before a recession, rate hikes have tightened financial conditions and slowed economic growth. This environment tends to see lower-risk, longer-duration assets outperform riskier sectors. It is at this point, just a year out from recession, that investors should look to become more defensive. Because as Sir John Templeton famously said, the four most costly words in investing are "This time is different."

Asset Returns in the Runup to Past Recessions



Source: Guggenheim Investments, Bloomberg. Average annualized returns are based on monthly asset returns during the 24 months prior to the last three recessions with start dates of 3.31.2001, 12.31.2007, and 2.29.2020, respectively. **Past performance does not guarantee future results.**

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