Stocks Are Down. Will the Economy Follow Suit?

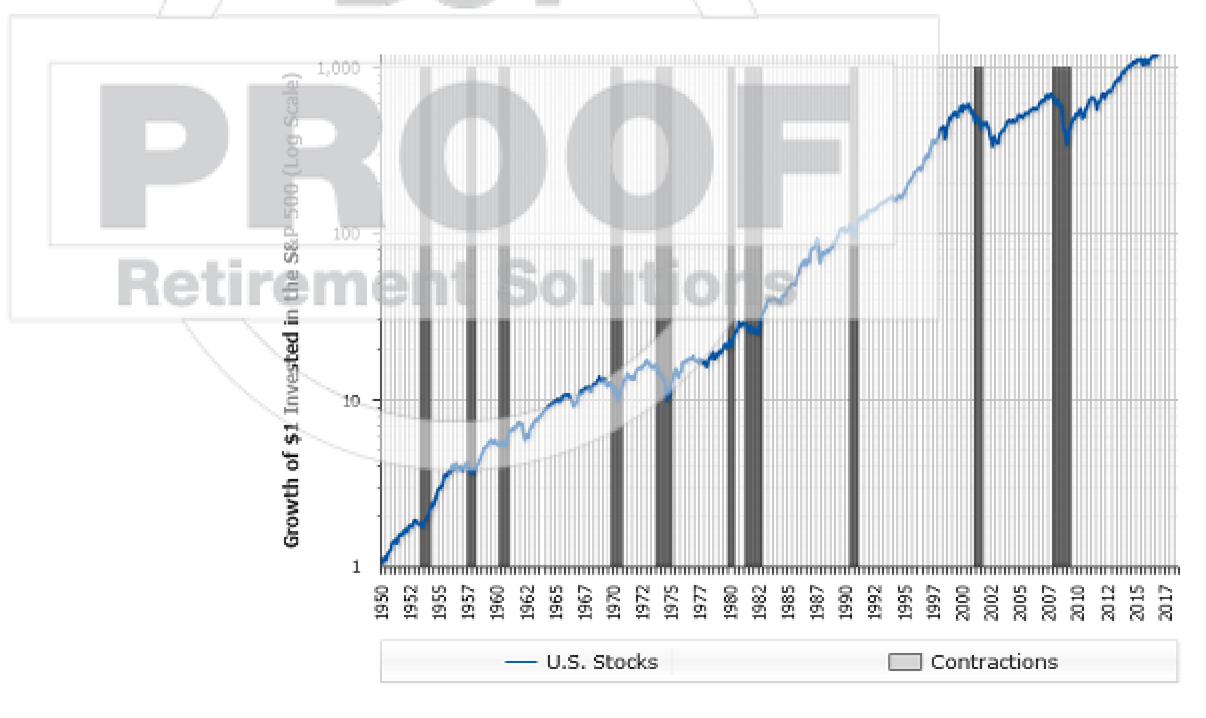
Conventional wisdom says that a stock market slump is a harbinger of recession. But history has shown that the market is a poor proxy for the economy. Many other factors can and do affect stocks.

"Wall Street indexes predicted nine of the last five recessions!" - Paul Samuelson

Interest rates are climbing. Inflation's on the rise. The housing boom is slowing. The trade war is escalating. And corporate earnings estimates are dropping. All these factors have sent major stock indexes plummeting, with the S&P 500 closing the year down 14% from its September high -- well into correction territory.

Does this all mean that the U.S. economy is headed for recession? Traditional wisdom says that a sustained correction or bear market is a portent of recession. And many economists think that is now the case. In addition to the above factors, they point to slowing growth in China, a flattening bond yield curve (which often precedes recessions), and an expansion cycle that is getting very long in the tooth. At 114 months, it is the second longest U.S. economic expansion since 1945.

U.S. Stock Market and Economic Contractions[2]



PROOF
DST Retirement Solutions

But other economic prognosticators see a different picture. Many point out that that the

U.S. economy is still growing at a healthy clip, with real GDP increasing at a 4.2% and 3.4% annual rate in the second and third quarters, respectively. They also note the positive effects of tax reform and that late-cycle expansions can last a long time. With no immediate catalyst for a drastic downturn, they instead see a "growing, but slowing" trend.

But both sides agree on one thing: the stock market has a very spotty history of predicting recessions. As Nobel Laureate Paul Samuelson famously quipped, "Wall Street indexes predicted nine of the last five recessions!"

In fact, a recent analysis found that the S&P 500 averaged *positive* performance in the 12-month, 6-month, and 3-month periods preceding the 14 U.S. recessions that have occurred since the 1920s. The study also found that, around 66% of the time, the market experienced a double-digit drop with no pending recession as the main cause. Of the 47 double-digit sell-offs during this period, 31 of them occurred outside of a recession and didn't happen in the lead-up to a recession.[1]

It's Not Just the Economy

For already-stressed investors, it's important to keep in mind that there are many other factors that drive stock markets besides the economic cycle. Interest rates, monetary policy, fiscal policy, political trends, trade balance, currency fluctuations, wars, world events -- you name it. Of course, many of these factors also affect the economy, but in different ways, and with different timing.

Whether a recession will or won't come in the near future is unknown. But it's unwise to assume it is a given just because stocks have taken a beating.

[1]Source: A Wealth of Common Sense, *Can the Stock Market Predict The Next Recession?*, Ben Carlson, October 23, 2018.

[2]Source: ChartSource®, DST Systems, Inc. For the period from January 1, 1950, through September 30, 2018. U.S. stocks are represented by the S&P 500 index, an unmanaged index that is generally considered representative of the U.S. stock market. Economic contractions are as defined by the National Bureau for Economic Research. It is not possible to invest directly in an index. Index performance does not reflect the effects of investing costs and taxes. Actual results would vary from benchmarks and would likely have been lower. Past performance is not a guarantee of future results. © 2019, DST Systems, Inc. Reproduction in whole or in part prohibited, except by permission. All rights reserved. Not responsible for any errors or omissions.

DST PROOF Retirement Solutions

© 2019 DST Systems, Inc. All rights reserved. Reproduction in whole or in part prohibited, except by permission. All rights reserved.