Long-term perspectives

Recessions: A part of the cycle

Wealth Management
Dominion Securities

Recessions are an ordinary phase of the broader economic cycle, but it is important to bear in mind that expansion is the normal state for the economy and downturns have typically been quite brief.

Recessions are a feature of the economic cycle

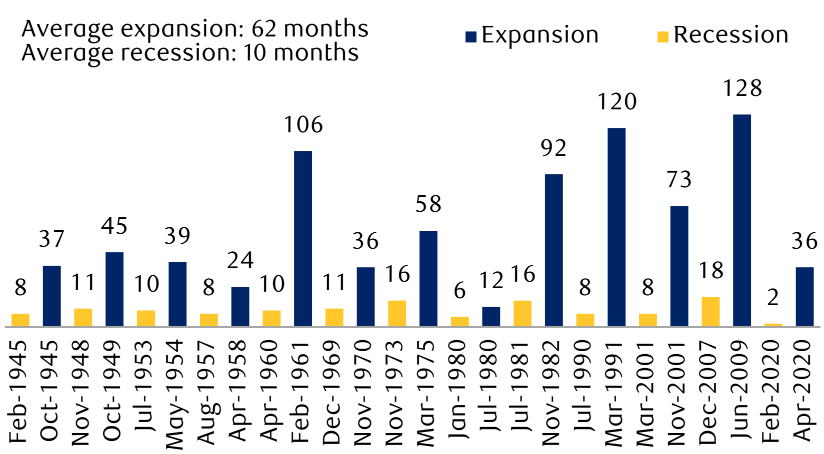
The business cycle refers to the recurrent cyclical patterns of the economy alternating between periods of expansion (growth) and recession (contraction). Technically defined as two consecutive quarters of negative GDP growth, recessions can be broadly described as sustained periods when economic activity falls and unemployment rises. All economic expansions eventually end with a downturn. Even though recessions can be unsettling, they are normal and relatively short-lived.

Expansions are the norm

While recessions tend to capture ample media attention, the natural state of the economy is growth. Our analysis of U.S. business cycles since 1945 shows there have been 13 recessions. This means investors should expect to experience an economic contraction once every six to seven years and lasting between two and 18 months, with a 10-month average. On the flip side, U.S. expansions have endured far longer—62 months on average. This implies over the past eight decades the U.S. economy has spent nearly 90 percent of the time in growth mode, which helps explain why over the long run corporate profits have trended upwards and equity markets have generated positive total returns in roughly 70 percent of calendar years.

Putting the economic cycle in context

Length of U.S. economic expansions and recessions since 1945



Source - RBC Wealth Management, National Bureau of Economic Research; data through 5/31/23

"Benefits" of recessions

Reframing economic slumps through the lens of opportunities can be useful for investors in maintaining discipline. Recessions can play a useful role of unwinding "excesses" and "imbalances" that may build up in the economy during an expansion, revamping the foundations for the recovery. The turbulent environment that recessions bring about can stoke efficiency gains, catalyze innovation, and foster the emergence of new companies and industries. Crucially, recessions can also surface opportunities in financial markets. Fears over the negative but temporary impact on corporate earnings tend to provoke substantial price declines in stocks and corporate bonds in the early stages of a recession. Excessive pessimism often pushes valuations to depressed levels that can present attractive entry points for investors to deploy capital at discounted prices, enhancing the prospect of earning above-average returns, in anticipation of the eventual recovery.

For important disclosures and authors' contact information, see page 2.

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