

It's official, the U.S. is in a recession ... now what?

Staying the Course:

HOW TO GROW IN TURBULENT TIMES

BY SETH P. HIEKEN AND BRIAN W. KATZ
THE COLONY GROUP
SPECIAL TO THE JOURNAL

On Dec. 1, the National Bureau of Economic Research unveiled the worst-kept secret of the year: The United States is in a recession. The NBER formally announced that “a peak in economic activity occurred in the U.S. economy in December of 2007.” This peak marked the beginning of the current recession, meaning that we recently have entered the second year of the recession — with no clear indication of when it will end.

With the NBER's announcement, we considered it an opportunity to review past recessions in an effort to identify useful observations. We recognize that this recession could prove to be very different from past ones. Nevertheless, factors that affect the equity and fixed-income markets, such as emotions and human psychology, have proven to be consistent throughout history.

The NBER is not the most punctual source when it comes to calling recessions. Markets are discounting mechanisms, with current prices derived from market participants' collective outlook of the future. It is therefore relevant to note historically that by the time the NBER has called prior recessions, the financial

markets often have reached or were nearing an inflection point. In three of the past four recessions, the S&P 500 already had reached its bottom by the time the NBER made its announcement.

Now that we know we're in a recession, we must determine its duration and magnitude. Again, we look to history as a potential indicator. Interestingly, recessions since World War II have been much shorter in duration than those that occurred prior to it. Pre-WWII recessions lasted on average 19.1 months. Post-WWII, the average recession has lasted half as long, or 10.2 months, with the shortest recession lasting only six months.

Why have modern recessions been shorter? We believe the speed at which information and transactions flow through the modern economy is at least partly responsible for this phenomenon. The extraordinary increases in productivity brought about by technological innovation have enabled corporations, consumers and investors of all types to process developments in minutes instead of days. This may explain why, during the current recession, we have had such an extreme decline in equity and bond prices in such a short period of time. Other important explanations for the differences between pre- and post-WWII recessions include the evolution of fiscal and monetary policy, such as the abandonment of the gold standard and the use of government spending to stimulate the economy.

Collectively, these factors may indicate that while the current recession has been severe, it may not endure for the

same length of time as pre-WWII recessions. The latest Wall Street Journal economic-forecasting survey suggests that, on average, the 54 economists surveyed expect the recession to end in June 2009. If that prediction holds true, then the current recession would last for a total of 18 months.

Of course, no two recessions are alike, and the short-term future of the markets cannot be predicted with any certainty. As we enter the 13th month of the recession, however, we are encouraged not only by the unprecedented globally aligned efforts of policymakers who have become more emboldened with their responses, but also, ironically, by the breakneck speed at which the financial markets have discounted the current economic contraction.

We are also encouraged by history, which shows that financial markets have seen some of their most significant gains in the months following recession lows. This should be a reminder of the importance of having a longer-term investment perspective. In spite of the extreme fluctuations of these markets, they move up more often than they move down, and in the end, investors who persevere are the ones that generally achieve the greatest returns.

SETH P. HIEKEN is Managing Director and **BRIAN W. KATZ** is Chief Investment Officer of The Colony Group, LLC in Boston. Staying the Course is a regular feature designed to help companies strategize during challenging economic times.