# Financial Insights

from Quinn+Cardy Wealth Management of BMO Nesbitt Burns

## How Does a Recession Impact My Portfolio?

We are currently experiencing a period of slower economic growth, largely due to the path that the central banks have taken to fight inflation. The aggressive rate hikes that began in 2022 were intended to help control inflation by slowing economic growth, but this has prompted ongoing concerns that these actions will push economies into recession. A recession is commonly defined as two successive quarters of declining gross domestic product (GDP), the measure used to gauge economic productivity. Is Canada at risk? Until now, our economy has been comparatively resilient, with robust consumer demand, healthy labour markets and resource production providing support.

#### How Have Rising Rates Affected Economies and the Markets?

Higher rates raise the cost of borrowing, which can lead consumers to spend less. While decreased demand for goods and services eases inflation, it can also impact a business' profitability. Rising rates also increase the cost for companies to borrow money, along with the cost of holding debt. Sometimes companies pass these costs along to consumers. However, if they cannot, it can potentially impact earnings and lower stock prices. As well, valuations often go down because the future value of cashflows is lower when a higher discount rate is used. With fixed income markets, as interest rates rise, bond prices generally fall. This is why we saw both stock and bond markets struggle in 2022 as the central banks raised rates.

#### **Recessions Are a Natural Part of the Economic Cycle**

It's not normal for any economy to be in a perpetual expansion and economic contractions, including recessions, occur from time to time. Economies, like financial markets, are cyclical in nature and prone to expanding and contracting. Recessions can also be quite different in their length and intensity. Consider that our most recent recession during the pandemic was the shortest on record, just two months in length.

#### What About My Portfolio?

The potential for a recession should never be a reason to consider curtailing investment programs. Consider that the stock market and



the economy don't always move the same way at the same time. History has shown that the markets can begin an upward climb when economic conditions are at their worst. A look back at the last seven U.S. recessions reminds us that the S&P 500 Index has, as often as not, started to climb during the depths of a recession (chart, below). After all, equity markets are forward looking in nature. Moreover, periods of retrenchment have been followed by new growth, expansion and improved equity values.

As such, during recessionary times, remember that these periods will be temporary. At the same time, longer-term investors should consider that portfolios have been positioned with the expectation that economies and financial markets will experience both ups and downs. This is a normal part of the investing journey.

#### What Happens to the Markets When There is a Recession?

#### S&P 500 Returns During Recession, One and Three Years After End

U.S. Recessionary Period	During Recession	One Year After	Three Years After
Nov. '73 to Mar. '75	-17.90%	28.32%	21.99%
Jan. '80 to Jul. '80	16.14%	12.92%	55.89%
Jul. '81 to Nov. '82	14.66%	25.40%	67.24%
Jul. '90 to Mar. '91	7.64%	11.04%	29.84%
Mar. '01 to Nov. '01	-7.18%	-16.51%	8.44%
Dec. '07 to Jun. '09	-35.46%	14.43%	57.70%
Mar. '20 to Apr. '20	-1.12%	45.98%	TBD

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