



Recession Signals Flashing Yellow

June 2022



KEY INSIGHTS

- Some major indexes have approached bear market territory, and concerned investors are asking if the U.S. economy could be heading for a recession.
- The global economy faces notable headwinds, and we believe that investors should adopt a defensive posture over the near term.

The persistent sell-off in global markets has many investors asking whether the U.S.—the world's largest economy—could be heading for a recession. With some major indexes in or near bear market territory, this is a valid concern given that, historically, eight out of the nine S&P

500 bear markets since 1950 have been associated with a recession.

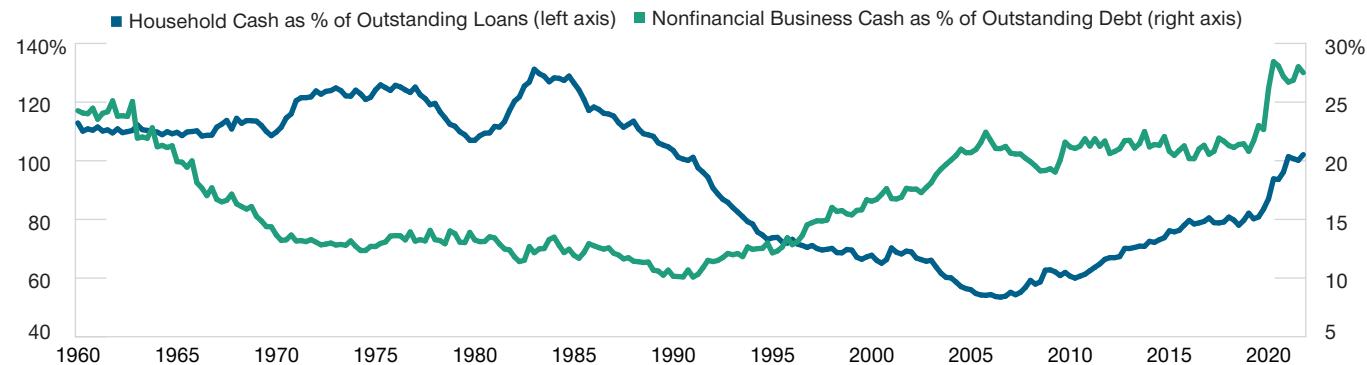
Although the global economy is on relatively solid footing to withstand slowing growth, it faces notable headwinds. On one hand, consumers and corporations have plenty of cash



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Reason for Optimism, Strong Balance Sheets

(Fig. 1) Household and corporate wealth could help buffer slowing growth



March 1960 to December 2021.

Source: U.S. Bureau of Economic Analysis/Haver Analytics.

Household Cash Includes: Households/Nonprofit Institutional Service Households: Assets: Money Mkt. Fund Shares + Currency and Deposits End of Period (EOP), Not Seasonally Adjusted (NSA), in Billions of Dollars (Bil.\$).

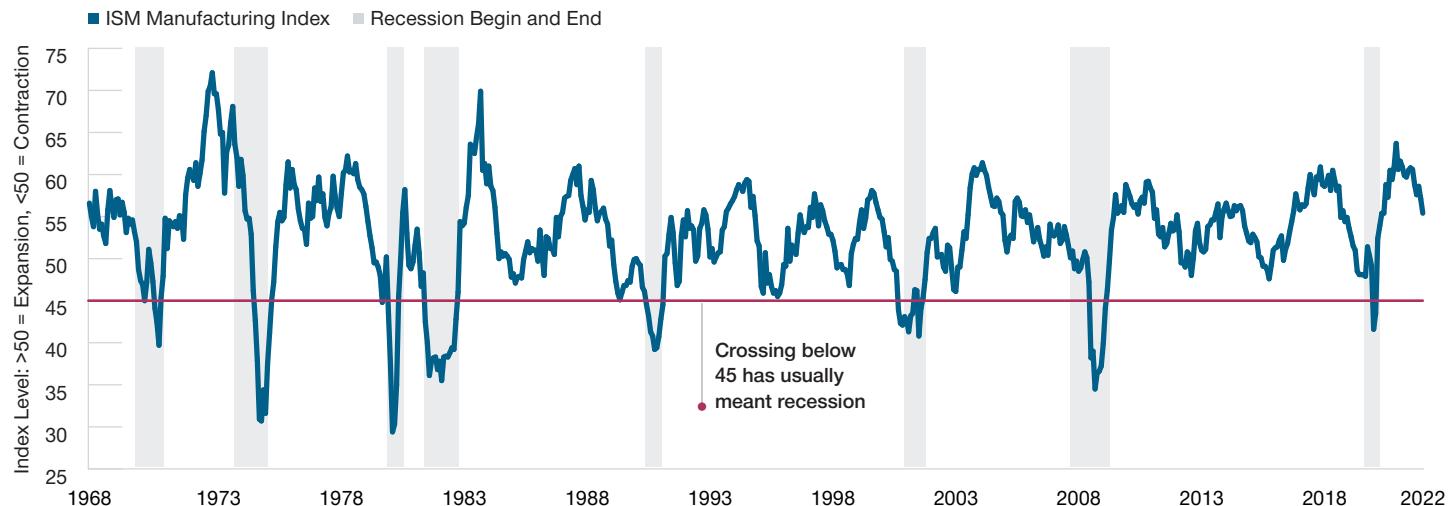
Household Loan Includes: Households/Nonprofit Institutional Service Households: Liabilities: Loans, EOP, NSA, Bil.\$.

Nonfinancial Business Cash Includes: Nonfinancial Corporate Business: Assets: Money Mkt. Fund Shares + Currency and Deposits EOP, NSA, Bil.\$ + Nonfinancial Noncorporate Business: Assets: Money Mkt. Fund Shares + Currency and Deposits EOP, NSA, Bil.\$.

Nonfinancial Business Debt Includes: Nonfinancial Noncorporate Business: Liabilities: Loans + Nonfinancial Corporate Business: Liabilities: Loans + Nonfinancial Corporate Business: Liabilities: Debt Securities.

ISM Manufacturing Index Is an Effective Gauge for Economic Growth

(Fig. 2) The index provides a timely barometer of economic activity



January 1968 to April 2022.

Sources: Institute for Supply Management, National Bureau of Economic Research/Haver Analytics.

and limited debt levels (Figure 1), and the general slowdown started during a period of rapid economic growth.

On the other hand, global central banks—led by the U.S. Federal Reserve—are tightening monetary policies aggressively, while governments around the world are pulling back dramatically on fiscal stimulus measures. Further, the pandemic has negatively disrupted supply chains and labor markets, and Russia's military aggression in Ukraine has damaged the global supply of energy, food products, and numerous industrial metals.

When gauging the probability of a recession, investors can assess various factors. For instance, the ISM Manufacturing Index is a barometer

of economic activity that is published monthly by the Institute for Supply Management. A reading below 45 on this index typically implies that a recession could be imminent (Figure 2). Deteriorating solvency is another red flag—in particular, widening credit spreads and significant negative performance in the high yield bond sector could indicate rising market fears about an increase in bankruptcies. A persistent uptick in the unemployment rate over several months would also be a concerning data point.

In our view, global markets are facing a challenging economic environment, and a recession in the U.S. could drive down financial markets even further. As a result, we believe that investors should adopt a defensive posture over the near term.

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