BULL AND BEAR

Hold Us To Higher Standards

Informed Investor Series

Anatomy of a Depression vs. a Recession
White Paper

The **Calm, Steady & Common Sense Series** explores how using emotion as your investment guide could cost you a return on your investments.

The **Anatomy of a Depression vs. a Recession** white paper examines our view concerning the difference between a depression like the Great Depression of 1929 and a more common recession. While every market is different and the past is not an indication of future events, this insight might help you stay a bit **Calmer, Steady, and employ Common Sense** the next time the media announces a declining market in a recessionary period.

During the Financial Crisis of 2008, the running joke in the media was that the difference between a recession and a depression is that when your co-worker gets laid off, it is a recession. When you get laid off, it is a depression.

While there was little to laugh about as the markets rattled back in the Financial Crisis of 2008, it did bring up a question between the definitions of the two events.

More recently, the global pandemic and the ensuing downturns in economic activity has rekindled the question of when circumstances are a recession and when they can be appropriately labeled depressions. The definition depends on the depth of the economic downturn and its duration.

What is a Depression?

Economists do not have an academic delineation to define or indicate when an economic downturn morphs into a depression.

Generally, we can explain a depression as a recession measured in years instead of quarters of economic contraction. The same factors that generate a depression are typically the factors and occurrences that cause a recession. However, a depression is far more severe than a recession, and it has a more broadly felt impact than a recession.

The Great Depression of 1929 started as a recession in the summer of 1929, and it would last almost four years. In terms of its severity, half of all banks failed, unemployment reached 25%, housing prices plummeted 30%, international trade dropped 65%, and prices fell 10%.[1]

What is a Recession?

The benchmark measure of our economy's strength is the gross domestic product (GDP). The "textbook" definition of a recession is two consecutive quarters of negative GDP.

How Do You Know When You Are in a Recession?

You often do not know when you are ***in*** a recession. You only know when you ***were in*** a recession. This is because there is no real-time data that economists can follow to see whether or not an economy has entered a recession. It is equally hard to tell if the recession will be a short one, a long one, or one that might tip into a depression.

Data that depicts market declines usually comes about after a recession has already made its presence known in the markets.

Are There Ways to Foresee a Recession?

The sage philosopher Yogi Berra once said, "It's tough to make predictions, especially about the future." Any attempt to gauge a recession is far from a science, as economists are literally "guessing," albeit educated guesses, the strength or weaknesses for components that go into measuring GDP. Some of the data considered include:

√ Job Market Report from the Department of Labor

Here you do not only want to look at the percentage of people unemployed but also the number of hours worked by full and part-time employees as employers will generally cut hours when demand is declining and they are worried about the future.

√ Leading Economic Index

Comprised of 10 components, this is a report from The Conference Board, a not-for-profit, non-governmental research organization that distributes vital economic information to its business members.

- Average weekly hours, manufacturing
- Average weekly initial claims for unemployment insurance
- Manufacturers' new orders, consumer goods, and materials
- Institute for Supply Management (ISM) Index of New Orders
- Manufacturers' new orders, nondefense capital goods excluding aircraft orders
- Building permits, new private housing units
- Stock prices, 500 common stocks
- Leading Credit Index
- Interest rate spread, 10-year Treasury bonds less federal funds
- Average consumer expectations for business conditions

The Leading Economic Index (LEI) intends to forecast future economic activity. The Conference Board determines the value of the index using the ten key variables above. These variables have historically turned downward before a recession and upward before an expansion. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy.

√ The Durable Goods Orders Report

This report tells you when businesses order new big-ticket items like machinery, automobiles, computers, furniture, commercial jets, and industrial equipment.

This report is important because historically, when the economy weakens, companies may postpone the purchase of expensive new equipment to save money. When they regain confidence in the future economy, they buy new equipment. As such, business orders generally decline as the economy worsens and will pick up when the economic downturn ends.

√ Confidence Level

While the indicators above are all mathematically based, the basis of the Confidence Level is how people feel. Several organizations measure the level of "emotion," including The Conference Board, the University of Michigan, and the National Federation of Independent Businesses.

The importance of these numbers lies in the implication that when consumers feel uneasy about their economic future, they are apt to pull back their spending, which causes sales to fall and is typically viewed as a recessionary factor.

Conclusion

We are more likely to sink into a recession than a depression in an economic downturn. While there are similarities, the key differences between economic recession and depression lie in the downturn's time, severity, and scope.

The key to keep in mind is that the safeguards put in place by lawmakers can make another economic downturn morphing into an event like the Great Depression of 1929 far less likely.

Sources:

(1) History.com, Great Depression History
https://www.history.com/topics/great-depression/great-depression-history

Disclosures:

Investments are subject to risks, including possible loss of principal. Investors should consider the investment objectives, risk factors and expenses of any investment carefully before investing. Diversification does not guarantee profit or ensure against loss.

The S&P 500, or the Standard & Poor's 500, is a stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 Index components and their weightings are determined by S&P Dow Jones Indices. It differs from other U.S. stock market indices, such as the Dow Jones Industrial Average or the Nasdaq Composite index, because of its diverse constituency and weighting methodology. It is one of the most commonly followed equity indices, and many consider it one of the best representations of the U.S. stock market, and a bellwether for the U.S. economy. You cannot invest directly in an index.

A bull market indicates a sustained increase in price, whereas a bear market denotes sustained periods of downward trending stocks - typically 20% or more. The term "bull vs bear" denotes the ensuing trends in stock markets - whether they are appreciating or depreciating in value - and what is the investors' outlook about the markets in general.

Bull markets generally coincide with periods of robust economic growth; investor confidence is on the rise, employment levels are generally high, and the economic production is strong. During the bearish phase, companies begin laying off workers, leading to a rise in unemployment and, consequently, an economic downturn.

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market.

Gross domestic product (GDP) is a monetary measure of the measure of the market value of all of the final goods and services produced in a specified time period.

The net interest rate spread is the difference between the interest rate a bank pays to depositors and the interest rate it receives from loans to consumers. The net interest rate spread is instrumental to a bank's profitability.

The Leading Credit Index constitutes financial market indicators including bond market yield curve data, interest rate swaps, and Fed bank lending survey data.

All examples are hypothetical and are for illustrative purposes only. We encourage you to seek personalized advice from qualified professionals regarding all personal finance issues. The solution for an investor depends on their and their family's unique circumstances and objectives.

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