*The following letter was written for you by the undersigned. The opinions expressed are those of your advisors at Gaskin Asset Management and do not necessarily reflect the opinions of Raymond James or its affiliates. We know this is a long letter, but we hope you will invest five minutes in reading it. Thank you*.

We have a longtime family history of visiting one of the Carolina beaches for a week or at least a long weekend each summer. We rarely miss this summer excursion and not even the pandemic could prevent the last few trips although a hurricane in 2020 almost washed us out. A beach trip can sometimes provide a fresh insight into the economy. For instance, the summer of 2009 revealed what seemed to be a “For Sale” sign in practically every other beachfront yard. While the “experts” make a career of analyzing data, sometimes economic trends are easily discerned by the casual observer. Following the real estate boom prior to the Great Recession, the glut of real estate for sale along beaches, lakes, and elsewhere was an unmistakable indicator of a market imbalance. Demand for real estate had collapsed which resulted in a tsunami in supply. We were in the midst of what would become a painful recession and the indicators were obvious.

Fast-forward to the summer of 2022. While the Great Recession seemed to catch so many by surprise, an economic decline this time around may not shock as many since it seems we are watching expectantly for its arrival. Some forecasters even believe we may already be in a recession. *Barron’s* Nicholas Jasinski noted that there is a growing consensus for a recession in the next year or two.[[1]](#endnote-1) His evidence is a June survey of 400 global investors conducted by Deutsche Bank where approximately 71% expect a recession in the U.S. in 2023 which is up from just 29% in February. We’ll take a moment to discuss the indicators later in this note.

After a strong 2021, the markets have experienced quite a downturn this year. If you’ve been checking your investment account statements, your 401(k) balances or online services, you already know the markets have given back a chunk of their gains since the pandemic rally. Since 1960, we have only experienced two first-half selloffs worse than this year’s S&P 500\* decline of 20.6% with the last one more than 50 years ago in 1970.[[2]](#endnote-2) It does appear to us that the U.S. stock market seems to be forecasting a recession. There’s a familiar old joke about the stock market and recessions. It goes something like this: The stock market has allegedly predicted ten of the last five recessions. Let’s just say that the stock market sometimes misses the mark when it comes to predicting major economic events. This is an appropriate moment to pause for a reminder that while the stock market tends to act as a barometer for the economy, the two are certainly not one and the same.

The economic and market volatility through the first half of this year is not just evident in the markets plunge. According to *The Wall Street Journal* graphics staff, tech stocks have sold off by more than 30% while crypto’s total value in circulation has dropped by about $2 trillion or more than two-thirds.[[3]](#endnote-3) And with inflation surging over 8% in the first half and rising interest rates, it’s no surprise to see that the bond market has also been hit with one of its worst years in decades. A common proxy used as the bond component of a diversified investment portfolio is the U.S. Aggregate Bond Index. After decades of consistent positive performance with few minor exceptions, the Bloomberg US Agg Index has suffered a double-digit decline through mid-year with a loss exceeding -10%. Worse yet, the Bloomberg US Government Long Bond Index is down more than -20% through June 30, 2022.\*\*

We discussed the damaging impact of inflation in our last newsletter. So, we thought it might be helpful to talk a bit about recessions. After all, a recession is what we fear will result from the Fed’s efforts to tame inflation. It’s safe to say that you probably know full well what a recession looks and feels like. You also know what it doesn’t look like. Now, back to the beach trip for just a moment. On the trip east, we noticed that gas prices at the pump were still high but lower than last month. That’s likely a temporary adjustment but a relief, nevertheless. Maybe you’ve noticed it too. The trip to the beach took about an hour longer than in previous years. Sure, maybe we did stop for fresh tomatoes and peaches at a roadside stand. Did I mention peach ice cream? Of course, how could you skip peach ice cream on a hot summer day? It was more expensive than last year but seriously, what are you going to do but pay? But ice cream wasn’t the only reason for the slower travel. The highways were packed with cars. As we got closer to the beach, the traffic began to slow down and became congested at each stoplight and turn. The beach is crowded, and it seems as if there are few, if any, beach houses available for purchase. This does not feel like a recession to us; at least, not yet.

According to the National Bureau of Economic Research (NBER), a recession is generally considered “a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales.”[[4]](#endnote-4) As mentioned in previous newsletters, a commonly used indicator for recession is two consecutive quarters of negative GDP growth. The business cycle includes periods of growth and expansion followed by periods of decline followed by expansion. Despite efforts to do otherwise, we cannot eliminate the inevitable decline that follows periods of excess.

A recent article in *Forbes* by David Rodeck provides helpful insight into recessions. Rodeck explains that as an economic expansion begins, the economy sees healthy and sustainable growth. Employment increases, income levels rise, and bank balances increase. Bankers and other lenders see the opportunity to make loans which encourages consumers and businesses to load up on debt. In response to the growing economy, asset values rise further while debt increases. Sound familiar?

There are a variety of economic conditions that can lead to a recession. Among them are a sudden economic shock as we experienced with the OPEC created oil crisis in the 1970’s, asset bubbles as we experienced in the late ‘90’s or excessive debt which led to the Great Recession. Inflation can lead to a recession also. That’s where we are today. We also have elevated asset values and there is the oil shock to the system brought on by several factors including the war in Ukraine. Nevertheless, corporate profits can continue to grow as long as prices can be passed along to consumers without dampening demand. But each household has its limit. Whether it’s a reduced travel schedule due to rising fuel costs or deferring a new car purchase because of sticker shock or delaying a home renovation due to excessive construction costs, we all have our limits, our points where price begins to seriously dampen purchase decisions. The technical indicators may not yet establish this period of time as a recession. In fact, it’s entirely possible that the slowdown will be so mild that we only realize we’ve had a recession when we see it in the rearview mirror. Again, only time will tell.

So, what should we do now? According to Raymond James Chief Investment Officer, Lawrence Adam, the stock market has already discounted about 98% of the pullback that we have historically seen during mild recessions.[[5]](#endnote-5) This means that the market may have already dropped enough for a mild recession. If this is true, the next big move could be up. That judgement requires that we assume the market performs accurately based on past experience and that we only experience a mild recession. We cannot be certain of either of those assumptions. The NBER tracks the average length of U.S. recessions. According to NBER data, from 1945 to 2009, the average recession lasted 11 months. Going back further prior to WWII, recessions lasted almost two years on average. We believe the shortening of these negative periods is largely a function of the economy’s ability to react and correct much more quickly due to technology and the ability of workers to move or work remotely. The U.S. economy witnessed a dramatic flexibility in many industries following the initial Covid shutdown.

It is important to recognize that following every big runup in equity prices, we enter a period where the market gives back some its gains as it seeks a level of stability. These recalibrations do not necessarily mean that the economy is heading into an extended recession. Sometimes it’s simply a repricing of asset values that had become too expensive. For example, the “price to earnings” ratio (P/E) for the S&P 500 has dropped from an average of 26 a year ago to its present level of about 20. That’s a significant correction and a much more reasonable valuation level if the economy is slowing.

We believe the present economic environment is presenting us with what appears to be mixed signals. We have inflation hitting levels not seen in decades. Yet, unemployment remains around 3.6%. The stock market is in bear market territory while home values remain elevated and inventory levels remain low. Interest rates are rising but remain well below levels of previous bull markets. This is a time to remain watchful but not anxious. There may be opportunities here. If we are heading into a recession, the market has already corrected significantly in anticipation. Some believe the market has “priced in” the most likely outcome. On the other hand, if inflation settles and the economy is able to react quickly, we may find the market overreacted. Either way, there is a possibility that the markets have either reacted appropriately in advance of a mild recession or they have overreacted for a slight slowdown. Then again, the current economic environment could be but a foretaste of something much worse to come.

When evaluating the economic and market outlook, we believe that this period is likely the normal functioning of the business and market cycles. Inflation did not surprise us nor does the market’s reaction. We believe this is a time to seek value rather than speculation when investing and allocate investment resources thoughtfully according to risk tolerance and time horizon. While we believe there are many opportunities available in this phase of the economic/market cycle, risks remain ever-present. We look forward to speaking with you soon. In the meantime, we hope you enjoy a wonderful summer with a chance to enjoy fresh peaches, vine-ripened tomatoes or whatever you most enjoy!

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\*S&P 500 Index – [a registered trademark of the McGraw Hill Companies] is an unmanaged index of common stocks representing 500 industrial, utility,

transportation and financial companies of the US markets (mostly NYSE issues).

\*\*Government bonds in this example are represented by the Bloomberg US Aggregate Bond Index and Bloomberg U.S. Long-Term (20-Year) Government Bond Index. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.

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1. Nicholas Jasinski, “The Second Half Looks As if It Could Be as Bad as The First”, Barron’s, July 4, 2022, p.33 [↑](#endnote-ref-1)
2. WSJ Graphics Staff, “The Selloff, and What Comes After”, The Wall Street Journal. July 2-3, 2022, p.B4 [↑](#endnote-ref-2)
3. WSJ Graphics Staff, “The Selloff, and What Comes After”, The Wall Street Journal. July 2-3, 2022, p.B4 [↑](#endnote-ref-3)
4. Benjamin Curry, “What Is a Recession?”, Forbes Online, June 20, 2022 [↑](#endnote-ref-4)
5. Lawrence Adam, “Deciphering the Market’s Difficult Message”, Raymond James Investment Strategy Quarterly, July 2022, pp.2-3. [↑](#endnote-ref-5)