Cougar Global Viewpoints

Fed Cycles and Recessions

AUGUST | 2023

Takeaways:

- Monetary policy works with long and variable lags.
- When the U.S. Federal Reserve (Fed) cuts rates, a recession is often near.
- A recession in 2024 would fit neatly with past Fed rate cycles.
- We haven't given up entirely on a soft landing, though the speed and scale of Fed rate hikes doesn't favor one.

Recessions happen, though they've been more infrequent in recent decades. Each one is different, and often has been caused by an unanticipated shock paired with a temporary change in the population's psychology. A changing interest rate environment can shift an economy's direction; thus, investors closely monitor the Federal Reserve's every move. The Fed pulls short-term interest rate levers, and, fairly or unfairly, takes the blame for driving an economy of 330 million people in the United States. As a result, it's intuitive to use the Fed as one of many recession indicators for anybody attempting to create a reasonable forecast of an oncoming recession. Like other macroeconomic gauges, monitoring and interpreting Fed rate hike cycles is far from precise, though it's useful enough for investors trying to keep the big picture in perspective.

Below is a table of the last 10 U.S. recessions, along with the associated dates of Fed interest rate hikes and interest rate cuts. Besides the variability of the data, there are a couple of notable observations. First, the expansion part of the business cycle (the length between recessions), has been longer in recent decades, with some academics attributing that to a more stable interest rate environment. Second, generally speaking, when the Fed cuts interest rates, outside of a couple of "soft landings" not shown here, a recession is often just months away. And finally, if we start counting from the time the Fed first increases rates as the second column shows, **the average timespan from the first rate hike to recession averages 27 months**. Of course **there's a wide-ranging gap, from one to three-plus years**, even if one throws out the final December 2015 data point, which could not possibly have forecast a pandemic (and recession)

First rate hike	Months from first rate hike to start of recession	Last rate hike	Months from last rate hike to start of recession	First rate cut	Months from first rate cut to start of recession	Recession start
Apr-1955	29	Aug-1957	0	Nov-1957	-3	Aug-1957
Sep-1958	20	Sep-1959	8	Jun-1960	-1	Apr-1960
Nov-1967	25	May-1968	20	Aug-1969	5	Dec-1969
Jan-1973	11	Aug-1973	3	Sep-1973	2	Nov-1973
Aug-1977	30	Mar-1980	-1	Apr-1980	-2	Jan-1980
Aug-1980	12	Dec-1980	8	Jun-1981	2	Jul-1981
Mar-1988	28	Feb-1989	17	Jun-1989	14	Jul-1990
Jun-1999	21	May-2000	10	Jan-2001	3	Mar-2001
Jun-2004	42	Jun-2006	18	Sep-2007	3	Dec-2007
Dec-2015	50	Dec-2018	14	Jul-2019	7	Feb-2020
Average	27	Average	10	Average	3	
Median	27	Median	9	Median	3	
Standard Deviation	12	Standard Deviation	7	Standard Deviation	5	

Souce: U.S. Federal Reserve, National Bureau of Economic Research, Cougar Global Investments as of 7/31/23 in 2020. Still, somewhat north of two years appears as a reasonable estimate based on previous Fed cycles, which **could put the timing of a recession into mid-2024.**

If you rework the analysis based on the Fed's final rate hike as noted in the fourth column, **the average of the last four business cycles suggests a recession occurs around 15 months after the Fed stops hiking rates**. Though debate rages on the central bank's next move, if the Fed's last hike occurred in July, a recession, while not imminent, may be looming.

Another rare "soft landing" is obviously still on the table, and we're encouraged by labor market data even though it appears oddly strong relative to history. To repeat a well-worn talking point, macroeconomics is not a field of precision and this has been a particularly unusual business cycle. Unprecedented fiscal and monetary activity, extraordinary debt dynamics, tense geopolitics, and gyrating commodity prices partially tied to a war in Europe are factors impacting inflation and thus economists' forecasts. After the most aggressive interest rate cycle we've seen since the 1980s, bond volatility has picked up and remained notably high while S&P 500 Index earnings may end 2023 around the same level as at the end of 2022. Admittedly, economists have struggled with their forecasts since the pandemic. Stranger things have happened, but based our analysis of past Fed actions, we appear to be closer to the end of a business cycle rather than the beginning of one.

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DEFINITIONS

The National Bureau of Economic Research (NBER) is a private, nonpartisan organization focused on facilitating research of major economic issues that include making the generally recognized official determination of when recessions begin and how long they last. NBER's traditional definition of a recession is that it is a significant decline in economic activity that is spread across the economy and that lasts more than a few months. The bureau's view is that while each of the three criteria – depth, diffusion, and duration – needs to be met individually to some degree, extreme conditions revealed by one criterion may partially offset weaker indications from another.

A soft landing is a cyclical slowdown in economic growth that avoids a recession.

Standard deviation is a measure of the dispersal or uncertainty in a random variable. For example, if a financial variable is highly volatile, it has a high standard deviation. Standard deviation is frequently used as a measure of the volatility of a random financial variable.

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The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

Indices are unmanaged, and one cannot invest directly in an index.

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