What's a Recession and How Can You Get Through One?

There's been a lot of talk lately about a recession, which economists define as two consecutive quarters of negative economic growth (as measured by a country's gross domestic product). How did we get to a point where a recession this year is more likely than not?

In a bid to rescue the economy from the damage done by the pandemic, central banks turned to ultra-low interest rates and governments used a variety of fiscal stimulus measures to kick-start growth. While this strategy encouraged spending, it also led to rising inflation as the cost of goods and services soared. In response, central banks worked to contain inflation by raising interest rates aggressively, hoping to dampen consumer and business demand. As the economy turns sluggish and debt levels increase amid sharply higher borrowing costs, a recession may follow.

What's the impact of a recession?

Many people fear recessions, given the expected economic weakness and instability. If economic growth slows and debt piles up, businesses may pause expansion plans and lay off a portion of their workforce. High unemployment curbs spending as many individuals and families manage their finances more cautiously.

In the early stages of a recession, we encounter rising prices on goods and services as inflationary pressures mount, causing higher interest rates and decreased purchasing power. Trying to make money stretch and maintain their quality of life without accumulating too much debt, people often forego discretionary expenses like travel and dining out, which slows the economy in general and negatively impacts businesses in those industries.

While the economy typically expands over time, recessions are a normal part of the economic cycle. According to the U.S. National Bureau of Economic Research, the average recession since World War II has only lasted about 10 months, but it can be a challenging time for consumers and investors.

How to manage in a recession

Keeping a close eye on debt is important in recessionary times. If interest rates are high (and rising), you could face larger payments on your credit cards, mortgage, loans and other debts. Try to reduce the amount you owe and watch your spending to avoid incurring excessive interest charges. Cooking at home, walking or taking public transit instead of driving, and cutting back on costly entertainment are some ways to lower your bills.

In addition to paying down debt, don't neglect your emergency savings fund. You never know when a large, unexpected expense may arise, such as home or vehicle repairs. Plus, you want to build a cushion in case you lose your job or work fewer hours. Generally, it's a good idea to put away three to six months of living expenses, but whatever you can save will help.

Investing in recessionary times

Since the economy slows in a recession, stock markets often decline to reflect diminished prospects for business growth. It's tempting to sell during a severe market downturn, but reacting rashly to short-term market declines may keep you from reaching your goals by locking in your losses and eroding your wealth.

Remember that recessions come and go, while the overall market's long-term trend is upwards. With help from your advisor, you can stay focused on your financial goals and ignore short-term market challenges. Depending on your circumstances, risk tolerance and time horizon, your advisor may even recommend investing more during a market downturn when prices are lower, so you can be better positioned to benefit when the economy rebounds. It's also generally wise to hold a well-diversified portfolio across asset classes, industries and geographies, which may help reduce portfolio risk while enhancing long-term returns. A skilled advisor can guide you through the economic cycle – including recessionary periods.

To learn more about how we can help you stay on track to achieve your financial goals, contact us today.

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