GUGGENHEIM

Crucial Conversations
Putting Pullbacks in Perspective

"Market pullbacks can be unnerving. That is why investors should make a plan with their financial advisors that addresses pullbacks and is informed by historical perspective, not emotion.

Pullbacks & Bouncebacks

We can gain important perspective on market pullbacks by considering post-World War II declines in the S&P 500® Index. The majority of declines fall within the 5-10 percent range with an average recovery time of approximately one month, while declines between 10-20 percent have an average recovery period of approximately four months. Pullbacks within these ranges are not uncommon, occurring frequently during the normal market cycle. While they can be emotionally unnerving, they will not generally undermine a well-diversified portfolio and are not necessarily signals for panic. Even more severe pullbacks of 20-40 percent registered an average recovery period of only 14 months.

The Deeper the Stock Market Decline, the Longer the Recovery[1]
Declines in the S&P 500® (Since 12.31.1945). Historically, the majority of market pullbacks have registered declines under 20%.

Decline %	Number of Declines	Average Decline %	Average Length of Decline in Months	Average Time to Recover in Months
5-10	84	(7)	1	1
10-20	29	(14)	4	4
20-40	9	(28)	11	14
40+	3	(51)	23	58

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In contrast, pullbacks of 40 percent or more, while occurring much less frequently, post an average recovery time of 58 months and can potentially compromise an investor's financial plan. Pullbacks above 20 percent (including all pullbacks above 40 percent), which have registered the longest recovery periods, have been associated with economic recessions. When evaluating a market pullback, the probability of a recession is a key insight to consider when determining whether or not to reduce equity exposure.

While recessions are readily identifiable in hindsight, prospectively they can be difficult to spot. This makes access to reliable market analysis all the more important when determining the probability of a recession.

“Real GDP growth increased by 6.5 percent annualized in the second quarter as the vaccine rollout and looser state restrictions allowed for greater services spending.

Where Are We Now?

(Guggenheim Investments provides its view of the current market environment as of 8.2021)

U.S. economic growth picked up in the first half of 2021 as new COVID-19 cases subsided and fiscal policy gained traction. Real gross domestic product (GDP) growth increased by 6.5 percent annualized in the second quarter as the vaccine rollout and looser state restrictions allowed for greater services spending. Private consumption will continue to power growth, as households are flush with cash due to the past year's pandemic-related spending constraints, record fiscal transfers, and surging equity and real estate valuations.

The combination of recovering demand and lingering supply constraints has led to price increases across a range of goods and services despite the prevalence of excess capacity in many sectors. This apparent contradiction can also be seen in the labor market data: The unemployment rate remains elevated at 5.4 percent—and the labor force participation rate is 1.7 percentage points below pre-pandemic levels—but a record share of small business owners report difficulty in finding workers. We expect these pandemic-induced supply constraints and associated price pressures to be transitory, as do most Fed officials who will largely ignore the noisy inflation data and focus on inflation expectations, which remain well-anchored. Our analysis suggests that the secular disinflationary headwinds of the past few decades will prove more lasting than a rise in prices due to temporary supply shortages.

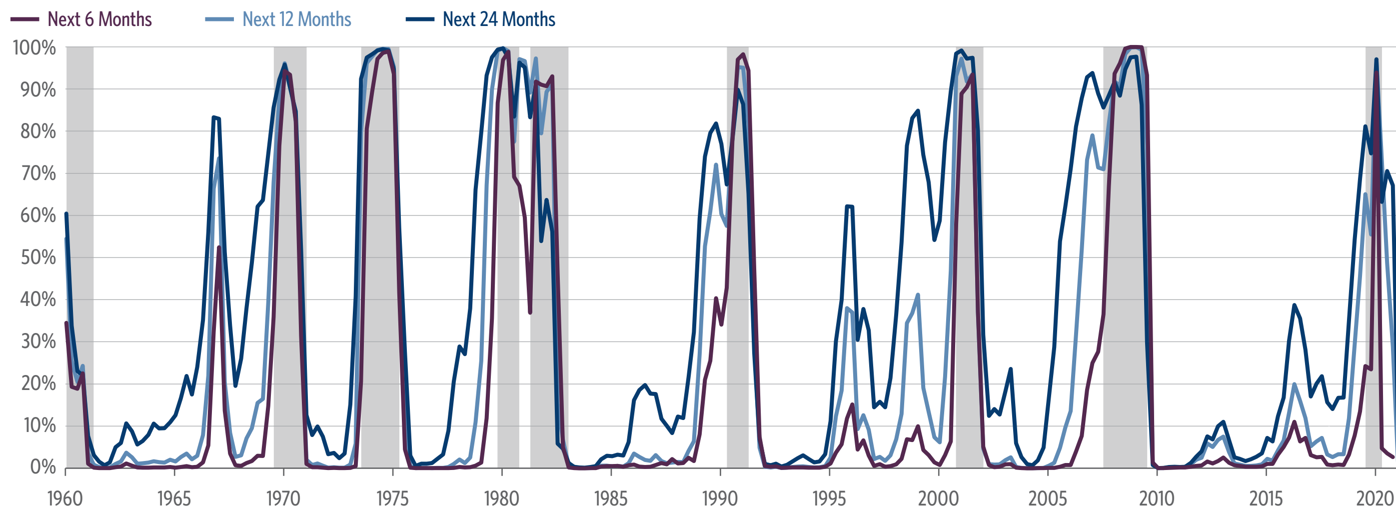
The world economy faces sharply divergent growth prospects, particularly given the rise of the more dangerous Delta variant, which will limit the Fed's ability to hike as soon as markets are pricing (25 basis points by March 2023).

The U.S. Economy Proved Resilient Against the Coronavirus, but Risks Remain

The business cycle is one of the most important drivers of investment performance. It is therefore critical for investors to have a well-informed view on the business cycle so portfolio allocations can be adjusted accordingly. After a quick and deep recession, our focus has pivoted to understanding how long and how durable the recovery will be. In addition, we are paying close attention to the spread of the Delta variant and the potential impact on markets and the economy.

Guggenheim has developed several tools to guide this effort. Our Recession Probability Model predicts the probability of a recession over six-, 12-, and 24-month horizons. As of the second quarter, we estimate the model points to very low risk of recession across all horizons. This low risk of recession is driven by still elevated labor market slack, substantial momentum in economic activity, and the continued impact of extremely easy monetary and fiscal policy. Naturally, there are substantial risks when forecasting the business cycle. Nevertheless, we believe that successful investing requires a roadmap, as with any other endeavor. Our investment team uses this roadmap to help guide our portfolio management decisions, in order to seek superior risk-adjusted performance over time and across cycles.

Recession Probability Model



Hypothetical Illustration. The Recession Probability Model was established in 2017 with no prior history of forecasting recessions. Its future accuracy cannot be guaranteed. Actual results may vary significantly from the results shown. This illustration is not representative of any Guggenheim Investments product. Source: Haver Analytics, Guggenheim Investments. Data as of 6.30.2021. Shaded areas represent periods of recession. Guggenheim's Recession Probability Model attempts to predict the probability of a recession over six-, 12-, and 24-month horizons. We developed the model using the unemployment gap, the stance of monetary policy, the yield curve, and the Conference Board Leading Economic Index (LEI), as well as the share of cyclical sectors of the economy (durable goods consumption, housing, and business investment in equipment and intellectual property) as a percent of GDP.

Interval Since Last Pullback

While there is a relationship between the days since the end of the last correction and the magnitude of pullback, as shown on the following page, the majority of pullbacks during non-recessionary periods registered declines under 20 percent. As we discussed earlier, pullbacks falling within the 5–20 percent range historically experience recovery periods of one to four months. These are not periods typically associated with severe economic deterioration, and do not necessarily represent a signal to reduce equity exposure. As of the date of this analysis (8.9.2021), there had been 959 days since a non-recessionary pullback of greater than 10 percent.

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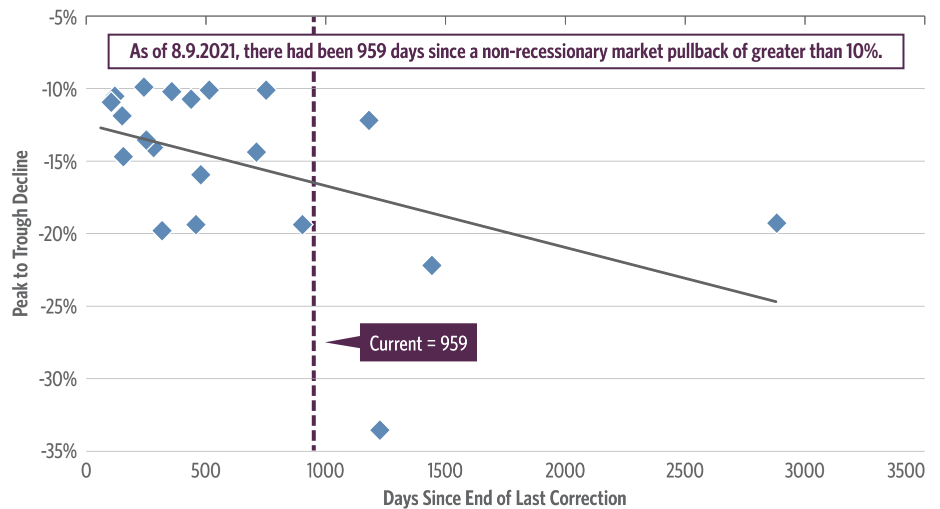
Ex Recession S&P 500 Corrections (>10% Decline)[3]

Since 1962



3 Source: Guggenheim Investments. Data as of 8.9.2021.

To learn more, speak to your financial advisor about Guggenheim Investments' timely insights and thought leadership.

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