STEPS TO TAKE TO HEDGE AGAINST A POSSIBLE RECESSION

Whittier Trust

Here's What To Do To Prepare For A Recession

Internet searches for "2023 recession prediction" are on the rise, indicating people are concerned about the state of the economy and, more specifically, their portfolios. Even with the current volatility—from high inflation to international geopolitical issues leading to a bear market—it's not all doom and gloom. At Whittier Trust, advisors and financial professionals make it their priority to protect and grow clients' wealth, through strategic planning and open communication, no matter the economic climate. Here, Whittier Trust Chief Investment Officer Sandip A. Bhagat shares answers to some top-of-mind questions on how to prepare for a possible recession.

How would you describe the Q1 2023 economic climate? Is there any indication that 2023 recession predictions may be valid?

The calls for a possible recession in 2023 have become almost universal by now. The skeptics point out that growth is already slowing, and the housing market is falling under the weight of higher interest rates. The yield curve has now been inverted for several months where long-term rates are lower than short-term rates, a historic predictor of an impending recession.

Against this gloomy backdrop of economic forecasts, a couple of metrics stand out in sharp contrast. The U.S. job market is strong: more than 500,000 new jobs were added in January 2023, job openings exceed 11 million and the unemployment rate is at a 50-year low at 3.4%. The U.S. consumer has also been resilient on the heels of the strong job market. Consumer spending in 2022, net of inflation, was in line with levels seen in a normal economy. The current strength of the U.S. economy appears to be at odds with a sharp and imminent recession and any 2023 recession prediction.

What would a possible recession mean for key industries and investment portfolios?

Recessions generally lead to lower corporate profits. Slowing revenue growth and lower profit margins both exert downward pressure on earnings. Stocks typically decline in the period leading up to and through a portion of the recession. Economically sensitive sectors such as consumer discretionary and financial services typically bear the brunt of the damage.

In the past, bonds have offered welcome relief in terms of diversifying an investment portfolio, as bonds tend to rally as stocks sell off.

Unfortunately, bonds have been unable to deliver this benefit in the current cycle for one simple reason: Inflation has been the root cause for a rise in interest rates and any related economic slowdown. Bond portfolios generally perform poorly when inflation and interest rates go higher.

A recession in this backdrop poses even greater challenges to an investment portfolio in the absence of diversification from bonds. Investors discovered few places to hide in 2022 as the prospects of a recession emerged, and 2023 recession predictions gained prominence.

How might advisors recommend clients adjust their portfolios to hedge against a 2023 recession prediction and further economic downturn?

Stock prices generally decline heading into and during the first half of a recession, when investors may be able to buffer portfolio losses through a greater allocation to cash, defensive economic sectors such as consumer staples and healthcare and diversified alternative investments which are less correlated to stocks.

We urge caution in seeking expensive recession hedges at this point. Any possible recession may be short and shallow. The worst damage to the stock market may, therefore, be behind us. There may be meaningful opportunity costs associated with turning ultra-defensive at this point. We instead recommend staying the course with awell-diversified portfolio.

Is it all negative? How can clients capitalize on this sort of economic climate or a possible recession?

We remain more constructive in our economic and market outlook than most industry observers. We point to the massive post-Covid monetary and fiscal stimulus that continues to support the economy and consumer and company balance sheets. The U.S. job market and consumer are remarkably resilient, and corporate earnings have, so far, held up better than in prior slowdowns. Either extreme of taking excessive risk or shunning it entirely may result in a costly mistake. We recommend holding a prudently diversified portfolio of stocks, bonds, cash and alternative investments.

Many are wondering what to do to prepare for a recession. What is your advice in the face of a 2023 recession prediction?

The inherent strength of the U.S. economy in this cycle may preclude a deep and protracted recession. A lot of the market damage from high inflation and the unfolding economic slowdown may have already taken place in 2022. As a result, we recommend staying the course with a well-diversified portfolio instead of making significant defensive changes.

By the time I found out there was a water leak at my property in Palm Springs, Brandi had already discovered it and had the leak fixed. It would've caused tens of thousands of dollars in damage by the time I discovered it because I never go out there. Neither does Brandi, for that matter. Why would she? She's my financial advisor. But she noticed the water bill was high so she drove out there to see why.
If paying bills and fixing plumbing don't seem like the job of a wealth management firm, maybe yours should be doing more. Because a big picture approach to wealth management starts with the little things.

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