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If I wanted to see if it was raining in, say, Zimbabwe, all I'd have to do is load my favorite weather app and I'd know within seconds. Similarly, if I wanted to find out if the Titans won last night, all I'd have to do is fire up Google.

But if I wanted to find out if we're in a recession or not? Well, that's a little harder to get an answer to.

Ever since summer began, people have been wondering whether we're in a recession. Many of my clients have asked me lately, too. Unfortunately, it's not as simple a question as it seems. Why? Because the very act of defining a recession is not as easy as you might think.

The *popular* definition of a recession, often repeated in the media, is two straight quarters of declining economic growth. But most economists don't think of recessions that way – it's too simplistic and may not accurately describe what's going on in the economy. Meanwhile, the *technical* definition, per the National Bureau of Economic Research – more on them in a bit – is "a significant decline in economic activity spread across the market, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales."[1]

But this word salad raises more questions than answers. For starters, how do you define "significant?" How many months is "a few?" Two? Three? Four? And finally, what if you see a decline in, say, GDP, but not in employment? Is it still a recession?

There's no question that there's a *ton* of economic uncertainty in our country right now. Skyrocketing inflation means we're paying more on everything from gas to groceries. To counter this, the Federal Reserve recently hiked interest rates for the fourth time in 2022. When interest rates rise quickly, it often – but not always – triggers a recession. So, there are good reasons to think a recession is in the cards.

But are we in one right now? Let's examine that question in a little more detail, before addressing what the answer means to us as investors.

The argument for a recession

The case for a recession is simple: The economy has shrunk for two straight quarters. In this argument, the popular definition of a recession is the correct one.

When I say, "the economy," what I really mean here is our nation's **gross domestic product**, or GDP. You probably remember hearing this term a lot in your college economics class, but in case you need a refresher, GDP measures the market value of all the goods and services a country produces in a specific period. In this case, the U.S.'s GDP fell by 0.9% from April through June, the second quarter in a row in which that's happened.[2] (In the first quarter, GDP dropped by 1.6%.[2])

There are many reasons GDP can decline. Data shows, however, that this particular decline was for one main reason: a drop in business inventory levels.

Okay, bear with me here, because we're about to get wonky. One component of how GDP is measured is how much inventory businesses have of whatever it is they actually sell. It's a *small* component – usually less than 1% of GDP[3] – but it's an extremely important one. That's because changes to these inventories can be a very effective signal for what business activity will look like in the future. For example, if businesses across the country stock up on their inventory, it often signals strong *demand.* Consumers want these products, are likely to *continue* wanting these products, and are willing to pay for them. In other words, there's likely to be a *lot* of buying and selling – i.e., business activity – in the short term.

Between April and June, however, inventories dropped. Businesses simply didn't see a need to invest in their inventory. They foresee supply outpacing demand – which is good for inflation, because it may bring prices down – but not for the overall economy. It's a signal of declining business activity, which is one of the hallmarks of a recession. Hence, a decline in GDP.

(We'll come back to this in a bit, because there's an interesting counterargument to the inventory angle.)

Another piece of evidence that we're in a recession is something called the **inverted yield curve.**

Okay, before I break down *this* piece of financial jargon, my advice is to get comfortable. If you're reading this during the day, make yourself a nice glass of lemonade and head outside to the hammock if you have one. If it's nighttime, get your fluffiest slippers and put the kettle on.

Ready? Okay, here we go.

A **yield curve** is a graph that depicts the relationship between long-term bond interest rates and short-term bond interest rates. Typically, longer-term bonds come with higher rates than short-term bonds because the bondholder needs to be compensated for investing for longer. (If I'm going to lend my money for ten years, as opposed to one, I expect to get extra compensation for it.)

Sometimes, however, the yield curve **inverts**, or flips over. When this happens, it's because interest rates for long-term bonds fall *lower* than those for short-term bonds. What prompts the flip? Investors getting nervous about what the immediate future holds. If bond investors feel that it's riskier to lend money in the short term than the long-term, then *they* start demanding higher interest rates. Otherwise, they'd prefer to just sock their money away for ten or twenty years and forget about it, thank you very much.

Why does this matter? Because almost every recession for the past sixty years has been preceded by an inverted yield curve. It's one of the major recession indicators that investors – and the media – watch for.

(We're not to "The Case Against a Recession" yet, but I want to clear up something before we go any further: An inverted yield curve does not *cause* a recession. It merely *predates* one. Remember, correlation does not equal causation. It's also important to note that, historically, recessions have occurred anywhere from 6 to 24 months *after* the yield curve inverts.[4] So, while such curves may have a Nostradamus-like reputation, they're an imperfect indicator at best.)

Another predictor for a recession is rising interest rates. Between June 2021 and June 2022, prices in the U.S. rose by 9.1%.[5] That's a level of inflation we haven't seen in decades. To bring prices under control, the Federal Reserve recently approved another interest rate hike. While higher interest rates are a proven tool for tamping down on inflation, they can also trigger recessions.

The final argument for a recession is that most consumers already *think* we are in a recession.

Here in the U.S., consumer confidence has slipped for three straight months, and is now the lowest it's been since early 2021.[6] That's important, because when people have low expectations about the economy, they tend to make recessions a self-fulfilling prophecy. When consumer confidence is low, people spend less. When people spend less, businesses sell less. When businesses sell less, industries produce less.

Add it all up and you have a declining GDP, a shrinking economy…and a recession.

The argument against a recession

Whoo-boy! That was a lot of words about why we're in a recession, wasn't it? So much so that it might seem overwhelming. But if you're someone who prefers to look on the bright side, always finds a silver lining, and sees the glass as half-full, you're in luck. Because there's evidence *against* a recession, too.

Let's knock these out one by one. First up, for every bit of data that suggests a recession, there's data that suggests the economy is actually doing okay. One of the most important is the labor market. As of June, 98% of the jobs lost during the pandemic have been recovered. The economy has added 2.2 million jobs since January. And the unemployment level has remained steady at 3.6%, which is just above where we were before COVID became a thing.[7] So while, yes, GDP has declined, it only tells half the story. Normal recessions show a decline in economic activity *across the board,* including both GDP and unemployment. So, while businesses may be reducing their inventories, they are still adding jobs.

There's also a possibility that the GDP argument is overblown right now. For one thing, remember how I said that GDP fell by 0.9% between April and June? That may turn out to be inaccurate. Quarterly GDP data is *always* revised several times as the relevant bureaus who gather and analyze said data – the Bureau of Labor Statistics and the Bureau of Economic Analysis – collect and refine more information. Sometimes, it turns out that the economy will have actually *grown* in the previous quarter when at first it looked like it fell. (The opposite is also true: It's possible that Q2 GDP could end up looking *worse* than first thought.)

Some economists also believe the business inventory data I mentioned may be a bit of a misnomer. You see, in 2021, many businesses ended up *overstocking* on goods they didn't actually need. Why? Because they wanted to ensure that future issues with global supply chains didn't leave them high and dry later. Think of it like going to the grocery store just before a blizzard hits. If you think it will be a while before you can get groceries again, you may end up buying more food than you can actually eat – food that will go to waste or sit unused in your pantry. This is what many businesses did in 2021.

So, what's an overstocked business to do? Simple: Balance things out by investing less in their inventory. There's a possibility *this* is why inventory levels fell so much during the second quarter. If so, it would suggest that the decline in GDP was largely artificial. Especially because, if you take inventory data *out* of the equation, our GDP would have actually gone *up* in Q2!

Want more data about why our economy might be okay? I can give you more. So far this summer, wages and salaries have increased along with jobs – hardly a sign of a recession. And while consumer confidence is down, consumer *spending* is up, having grown 1.1% in June.[7]

Add all *this* evidence up, and you have a picture that looks more like an economic cooldown than an economic recession. Which, of course, is exactly what the Federal Reserve hoped for when it started raising interest rates to bring down inflation.

Who decides whether it's a recession, anyway?

Over the last decade or so, economic data has become weaponized by politicians hoping to win the next round of political football. Every time there's a slowdown in the economy, the party that holds power in Washington has an incentive to declare "Everything's fine" so that they can stay in power. And the party that *wants* to be in power has the incentive to say, "Everything's falling apart."

That's what we're seeing now.

So, after reading all the arguments for and against a recession, you're probably wondering whose job it is to figure out the answer officially. Early in this message, I mentioned an organization called the National Bureau of Economic Research. (NBER for short.) Inside the NBER is a small group of economists called the "Business Cycle Dating Committee." This is the body that officially declares a recession.

While this group is officially part of the government, they have a long history of nonpartisanship. The proof of that is in how long they take to issue pronouncements. You see, the committee does not analyze whether we're in a recession or not in real time. Instead, they take months to make the call, usually waiting until the evidence is overwhelming and undeniable. (Clearly, we're a long way from this.) Sometimes, the recession may have already come and gone before the committee says anything. While this can be frustrating, there's a good reason for it: Their research is for the benefit of historians and economists who are seeking to learn from the past. Not politicians and pundits who are looking for easy talking points. So, it may be a long time before we officially know the answer to the question I posed at the beginning of this message. That means we need to take everything we hear in the media, or out of Washington, with many grains of salt and not overreact to any one piece of data.

Why the question doesn't matter as much as you might think

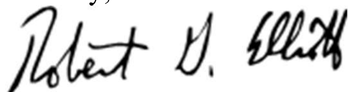
Make no mistake: Recessions are a big deal. But as *investors,* the real danger is less about whether we're in a recession or not, and more about whether we *overreact* or not. To illustrate what I mean, I'd like to tell you a story. This is an old fable that first appeared in magazines at least as far back as the 1950s, but it's still relevant to us today.

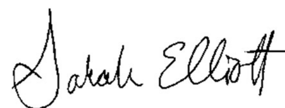
> There was once a man who sold hot dogs on the side of the road. He was hard of hearing, so he had no radio. He had trouble with his eyes, so he never watched television. But he sold good hot dogs.
>
> He put up a sign on the highway, telling people how good they were. He stood by the side of the road and cried, "Buy a hotdog, mister!" And people bought.
>
> He increased his meat and bun order and bought a bigger stove so he could make more hot dogs. Then he asked his son, who was home from college for the summer, to help him. But then something happened. His son said, "Dad, haven't you been following the news? There's a recession coming. The international situation is terrible, and the domestic situation is even worse."
>
> The man thought, "Well, my son is very smart. He watches the news, so he ought to know." So, the man cut down on his bun order. He took down his advertising signs. He worked fewer hours. And he never cried, "Buy a hot dog!" because times were hard, and he figured nobody would or could.
>
> His hot dog sales fell overnight.
>
> "You were right, son," the man said. "We are certainly in the middle of a recession."

You see, the worst mistake an investor can make during times like these is to stop making decisions based on what they *know* in favor of what they *don't.* The man in the story knew how to make good hot dogs. We, in turn, know how to make sound investment decisions. Our investment strategy is designed to work over the long-term, in good times and bad, and so long as we stick to that – so long as we keep making good hot dogs – then we will keep moving forward to your long-term financial goals.

So, are we in a recession? I'll leave that for the economists to decide. All I know is that I remain confident in the direction *we* are going, and I look forward to helping you continue in that direction for years to come. As always, please let me know if you have any questions or concerns. My team and I are always here for you. Enjoy the rest of your summer!

Sincerely,





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