GUGGENHEIM

# 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 have registered an average recovery period of only 14.0 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 |
|---|---|---|---|---|
| 40% | 3 | -51.4 | 22.8 | 58.0 |
| 20% | 10 | -27.7 | 10.5 | 14.0 |
| 10% | 28 | -14.0 | 4.0 | 4.0 |
| 5% | 86 | -6.7 | 1.0 | 1.5 |

1. Guggenheim Investments. Data as of 2.8.2024.

In contrast, pullbacks of 40 percent or more, while occurring much less frequently, post an average recovery time of approximately 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.

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## Where Are We Now?

Economic conditions have been in a sweet spot recently, with solid real gross domestic product (GDP) growth, a labor market cooling toward a more sustainable pace even with layoffs remaining very low, and inflation arguably already back under the Federal Reserve's (Fed's) 2 percent target (see for example core PCE inflation over the last six months). Whether by design or just good luck, the most acute negative impacts from the Fed's tightening were largely cushioned by expansive fiscal policy in 2023. Meanwhile, inflation managed to cool significantly despite solid (but slowing) aggregate demand because the supply side showed rapid improvement, including both from international supply chains and expansion of the labor force.

As we look ahead to 2024, the market seems to be extrapolating that this positive confluence of economic forces will continue to strike a perfect balance. That is a real possibility, particularly with the Fed making a more dovish shift and the associated easing in financial conditions taking some pressure off the economy. But in our view the long list of macroeconomic risks is underappreciated. Chief among these risks is a further cooling in demand that transitions the economy from a gradual slowdown to an abrupt downshift. The economic outlook has gotten more positive now that further Fed hikes are off the table and broad financial conditions are easing as substantial rate cuts are priced in. But with markets priced for such a benign outlook, we continue to expect volatility as risks of something upsetting the favorable growth-inflation mix remain elevated.

### High Recession Risk as the Lagged Effects of Monetary Tightening Continue

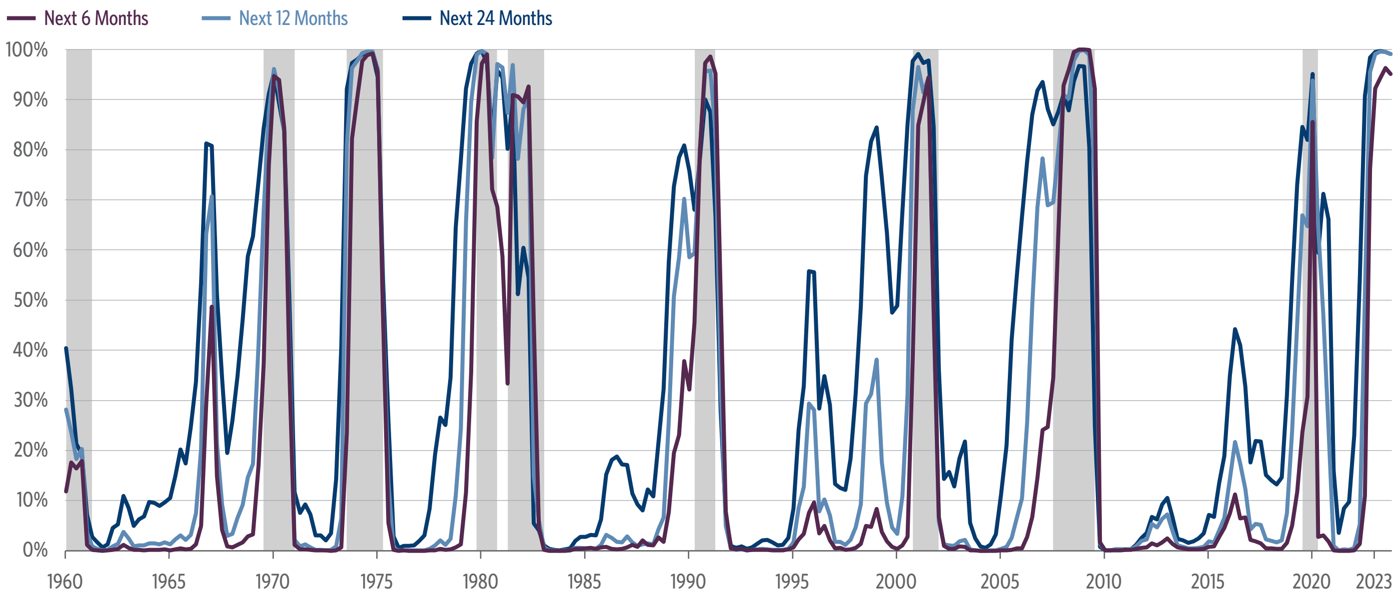
The business cycle is one of the most important drivers of investment performance. It is therefore critical for investors to have a well-informed view on the business cycle so portfolio allocations can be adjusted accordingly. While we are just a few years from the last recession, our focus has again turned to forecasting recession timing, given slowing economic activity, tightening credit conditions, and a Fed intent on slowing demand further.

Guggenheim Investments 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 fourth quarter, the model points to very high risk of recession in the next several months, with leading indicators of economic activity falling at a pace seen in the runup to prior recessions. Other warning signs include the lagged impact of aggressive Fed tightening, an inverted but steepening yield curve, and signs of weakness in the labor market. 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.

## Interval Since Last (10%+) 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

## 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: Guggenheim Investments, Haver Analytics. Data as of 12.31.2023. 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 cyclicatl sectors of the economy (durable goods consumption, housing, and business investment in equipment and intellectual property) as a percent of GDP.

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 (2.8.2024), there had been 484 days since a non-recessionary pullback of greater than 10 percent.

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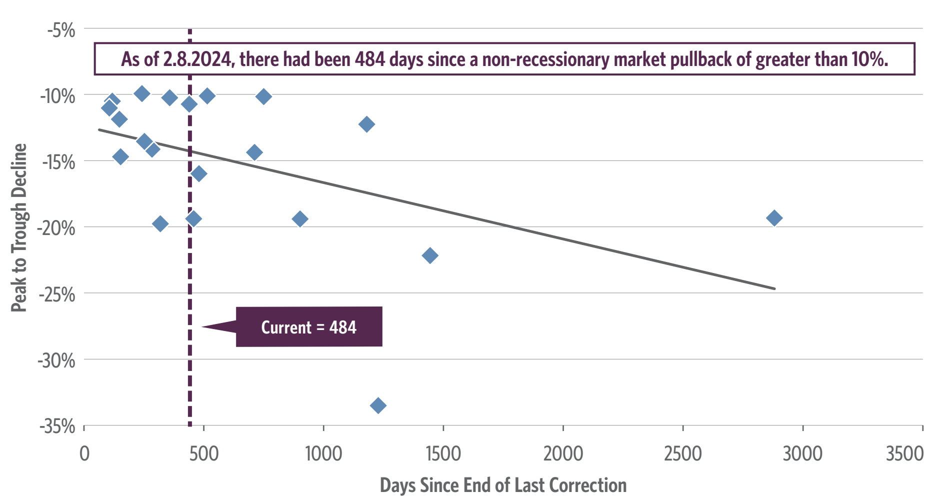
### Ex Recession S&P 500 Corrections (>10% Decline)

Since 1962




Source: Guggenheim Investments. Data as of 2.8.2024.

## Putting Pullbacks in Perspective

Pullbacks are often not a time to panic and should rather be used as a reason to analyze and assess. Under certain circumstances, it may even be the case that a pullback represents an attractive buying opportunity for certain portfolios. The benefit of gaining reliable market and economic perspective is essential in preparing for market pullbacks. Rather than act on emotion, it's important to put these events in context to determine what they mean.

Working with your financial advisor, you may then better assess any potential impact on your portfolio and implement a proper course of action, if any is necessary, that is in line with your investment objectives.

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



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