Navigating a recession

Early efforts to contain the COVID-19 outbreak saw economic activity come to a virtual standstill between April and June, officially pushing the UK into its first recession since 2009.

What is a recession?

For a country or region a recession is considered to be happening when Gross Domestic Product (GDP) - the most widely used indicator of economic growth - falls for two successive quarters.[1]

Official confirmation of a recession takes time but we now know that UK GDP fell by 20.4% between April and June.[2] Much of this decline was concentrated in April, at the height of lockdown. While the easing of restrictions in June led to some increase in economic activity, this remained well below pre-pandemic levels.[3]

Understanding what can happen in a recession can help equip you, as an investor, to navigate your way through it with more confidence.

Your quick guide to investing through the recession

1. Know what you're dealing with

Recessions are part of the economic cycle, although they can be triggered by an external event such as COVID-19, and most people will experience at least one while on their investment journey.

What we don't yet know is how deep this recession will be and how long it will last.

Opinions are evolving as events unfold, but by the second half of June the World Bank expected it to be the worst since the Second World War [4], while the International Monetary Fund (IMF) thought the world economy would shrink by 4.9% this year (more than the 3% it predicted in April), with growth of 5.4% in 2021 (down slightly from the 5.8% it predicted in April).[5]

There are also several versions of how the recovery could play out. One possibility is what's referred to as a V-shaped recovery, where a sharp dip in economic activity is followed by a steep and quick upwards return to pre-coronavirus levels.

Another scenario is a U-shaped recovery, with a sharp slump and a gradual return. You may also have heard talk of a 'swoosh' shaped recovery in which a sudden dip would be followed by a quick rebound that then slows down into a more gradual return to pre-coronavirus conditions. This is the version currently favoured by the Bank of England, which forecasts a faster initial rebound with the UK economy only returning to pre-pandemic levels at the end of 2021.[6]

2. Know what to look for

The Bank of England cut interest rates twice in the space of one week in mid-March, first to 0.25% and then to an historic low of 0.1%[7], which has since been maintained[8], in order to reduce borrowing costs for businesses. It hasn't ruled out reducing the base rate to zero over the coming months or even taking it into negative territory.

Other central bank options include quantitative easing, where it creates 'new' money with which to buy government or corporate bonds. The aim here is to keep interest rates down so people can borrow money, boost spending and limit the ups and downs of the investment markets to encourage investing.

The Bank of England announced £200bn of quantitative easing in March[9] and another £100bn in June, but expects a lower level during the rest of 2020.[10]

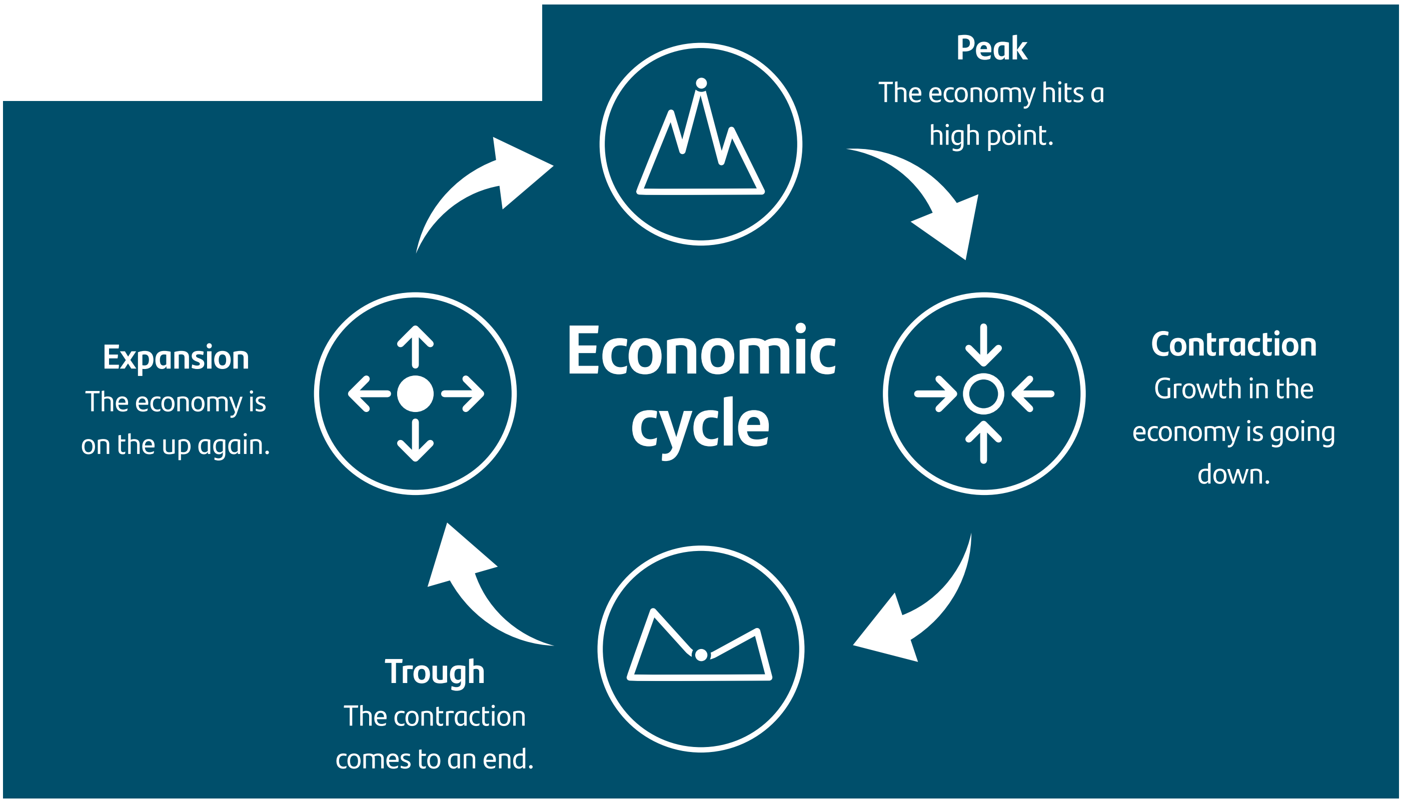
What do the decision makers look out for?

Important indicators which will inform future actions include: interest rates, inflation, employment levels, retail sales, benefit claimant data, financial asset prices and trade balances (imports and exports).[11]

UK inflation fell to a four-year low in May with only a slight increase in June.[12] July saw more of an increase[13] as lockdown restrictions eased, but further falls as a result of coronavirus are predicted and the Bank of England expects it to take around two years for inflation to return to its target 2% level.[14] The number of people in work in the UK fell by 730,000 between March and July with further job losses expected to follow in the coming months as the impact of the pandemic continues to ripple through the UK economy.[15]

3. Remember, everything is temporary

Economic cycles usually follow the same pattern each time: peak, contraction (or recession), trough and expansion (or recovery). What we don't know, however, is how long each stage will last and when the next will begin.



For example, looking overseas, the US National Bureau of Economic Research indicates February 2020 was the point at which the US economy reached a peak, marking the start of a recession and the end of the expansion that began in June 2009. That expansion was the longest on record - something few would have anticipated in the immediate wake of the 2008/9 financial crisis.[16]

4. Stick to the basics of investing

We always need to remember that what's happened before is no guarantee of what will happen in the future, but history tells us that investing has tended to perform better than savings over the long-term.[17] So it's helpful to maintain a long-term view and remember that markets always move in cycles.

It can be tempting to walk away when investment markets are falling, particularly as the emotions of fear and anxiety kick in. But giving in to these feelings can be costly. Not only could you be selling your investments at a lower value, you also risk missing out on the growth which comes with recovery.

For example

The MSCI World Index fell more than 30% between May 2008 and February 2009, before bouncing back by more than 40% by the end of 2009[18] (albeit still lower than its level before May 2008).

If you are a regular investor you will buy units in funds at different times and different prices, which means you buy more when prices are low and so stand to benefit more when they rise.

What's next?

We are entering a turbulent period. Investment portfolios will inevitably be affected by what is shaping up to be a sharp economic downturn. Already we have seen investment markets drop quickly and then begin rising again many with ups and downs along the way, and it's likely this type of pattern will continue. However, the fundamentals of investing remain unchanged.

Some assets, regions and companies will do better than others even in a recession. There are always opportunities to take advantage of, particularly if you're drip-feeding money into a portfolio that is well diversified across a mix of different asset classes and investments.

If you're unsure about anything to do with investing or your financial plan, you may find it helpful to talk things through with a financial adviser.

Find out more

Visit our **State of play** for the latest macro views and to find out what is driving financial markets. And, if you are interested in reading more on economic cycles and investment themes, take a look at our **Insights** or **Back to basics** guide.

Let's be clear!

Investment terms explained

Asset class: A group of investments with similar traits. Shares, Bonds, Property, Cash and Alternatives are all examples of asset classes.

Bonds: A Bond is a loan issued by a government or a company. When you buy a Bond, the issuer promises to pay a certain amount of income until the Bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the Bond. This is known as creditworthiness.

Corporate Bonds: Bonds issued by a company as a way of raising money to invest in their business. They have nominal value which is the amount that will be returned to the investor on a stated future date (the redemption date). These bonds are bought and sold on the market and their price can go up or down.

Diversification: Spreading your money across different investments to help manage risk.

Government Bonds: Bonds issued by governments.

Index: A way of tracking the overall performance of a basket of individual investments of a similar type. For example, the FTSE 100 index tracks the performance of Shares in the 100 largest companies by market value on the London Stock Exchange.

Inflation: Measures the increase in price of selected goods and services in an economy over a period of time.

Portfolio: a group of investments that are managed together to meet a particular objective.

[1] Investopedia - Guide to economic recession - 8 June 2020
[2] ONS – Coronavirus and the impact on output in the UK economy: June 2020 – 12 August 2020
[3] BBC – UK officially in recession for the first time in 11 years – 12 August 2020
[4] World Bank - World Bank: COVID-19 recession is expected to be twice as bad as the 2009 - 18 June 2020
[5] Bloomberg – IMF Projects Deeper Global Recession on Growing Virus Threat – 24 June 2020
[6] Financial Times – Bank of England tempers forecasts for UK economic rebound – 6 August 2020
[7] BBC - Coronavirus: UK interest rates cut to lowest level ever - 19 March 2020
[8] Bank of England – Bank Rate maintained at 0.1% - August 2020 – 6 August 2002
[9] Guardian - Bank of England warns of long term damage to economy - 26 March 2020
[10] CityAM - Bailey: Bank of England will reverse QE before raising rates - 22 June 2020
[11] Investopedia - The Top 10 Economic Indicators in The UK - 28 May 2019
[12] ONS – Consumer Price Inflation: June 2020 – 15 July 2020
[13] ONS - Consumer Price Inflation - 19 August 2020
[14] Bank of England – Bank Rate maintained at 0.1% - August 2020 – 6 August 2020
[15] ONS - Labour Market Overview, UK: August 2020 – 13 August 2020
[16] NBER - NBER Determination of the February 2020 Peak in Economic Activity - June 2020
[17] Nerdwallet.com - What Is the Average Stock Market Return? - 22 October 2019
[18] Tilney - It's about time in the markets, not timing the markets - 17 October 2019

Important Information