Timing the Stock Market Around a Recession (It's Harder Than You Think!)

The market consensus appears to indicate expectations of a recession to start later this year. What does this mean for stock market investors? Is it possible to time the market and preserve capital by predicting the onset of and recovery from a recession?

The table below shows the 12 recessions that occurred in the post-World War II era. The first column shows the price changes of the S&P 500 during the recession with, perhaps, a surprising conclusion. The stock market actually rose in 50% of the recessions, with an average loss over all periods of only 0.2% (the clear outlier was the Global Financial Crisis of 2008-2009, which we will discuss shortly). Even with perfect foresight of the start and end of a recession, selling stocks at the beginning of a recession and buying them back at the end has resulted in preservation of capital only 50% of the time.

S&P 500 Price Changes During Post-World War II Recessions

RECESSION		S&P 500 PRICE CHANGE			
Start	End	During Recession	3 Months Before Start to Recession End	3 Months Before Start to 3 Months After Recession Ends	Recession Start to 3 Months After Recession Ends
11/30/1948	10/31/1949	8.7%	0.4%	6.8%	15.6%
07/31/1953	05/28/1954	17.9%	18.6%	21.2%	20.5%
08/30/1957	04/30/1958	-3.9%	-8.4%	-0.5%	4.4%
04/29/1960	02/28/1961	16.7%	14.1%	19.7%	22.4%
12/31/1969	11/30/1970	-5.3%	-6.4%	3.9%	5.1%
11/30/1973	03/31/1975	-13.1%	-20.0%	-8.7%	-0.8%
01/31/1980	07/31/1980	5.7%	19.5%	25.2%	5.7%
07/31/1981	11/30/1982	5.8%	4.3%	11.4%	13.1%
07/31/1990	03/28/1991	5.4%	13.4%	12.2%	4.2%
03/30/2001	11/30/2001	-1.8%	-13.7%	-16.2%	-4.6%
12/31/2007	06/30/2009	-37.4%	-39.8%	-30.8%	-28.0%
02/28/2020	04/30/2020	-1.4%	-7.3%	4.1%	10.7%
Average		-0.2%	-2.1%	4.0%	5.7%
Median		2.0%	-3.0%	5.5%	5.4%
% Positive		50.0%	50.0%	66.7%	75.0%

Data from 9/2/1945–4/30/2023
Source: FactSet

What if you had perfect foresight and were able to anticipate the start of a recession, let's say, three months before the recession actually began, and then bought stocks back when the recession ended? Column 2 in the table shows the S&P 500 price performance over those periods and, again, 50% of the time the market rose over the period. However, the average and median gains over the periods suggest that there would have been at least some potential benefit from having such foresight.

But what if you're late in identifying the end of a recession? Column 3 in the table shows the result of anticipating the start of a recession by three months but then identifying the end of a recession three months after it actually ended. Column 3 shows the market rising two-thirds of the time in these periods, with an average gain over all periods in the mid-single digits.

Finally, what if you have perfect foresight in identifying the start of a recession but are three months late in identifying its end? Column 4 shows the market rising 75% of the time in these periods, with an average gain over all periods, again, in the mid-single digits.

The object of this exercise is to point out that it is extremely difficult to use predictions about recessions (even if they are accurate) in order to time the stock market. To be sure, if an investor had been able to predict the 2008–2009 recession with even partial accuracy, they would have reaped significant benefits. However, this is an exception rather than the rule. The 2008–2009 recession was global in its effects. It resulted in a significant breakdown of the financial system, and it was both the deepest (in terms of GDP decline) and longest of any other recession since World War II. Most recessions have been far less severe than the Global Financial Crisis of 2008–2009.

It will be undoubtedly stressful for stock market investors if a recession unfolds later this year or next, but history suggests that making market timing decisions based on recession predictions isn't likely to add much value.

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REFERENCED INDEX

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