Recession **OPPORTUNITIES**

Past, Present and Future Recessions

A Three-Part Series – The 'Recession Opportunity Kit'

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Introduction and Abstract:

Economies engage in a natural business cycle of economic activity. Although troubling, recessions are an inherent part of the economic cycle. They may be caused by a variety of events, most notably restrictive central bank policy (Fed tightening the money supply too vigorously), commodity spikes, or the bursting of an economic bubble. This paper is intended to explore three aspects of recessions, examining:

- *The 11 recessions of the last 70 years, their severity and prospectively what caused them*
- *The probable leading indicator of a recession and current statistics on that and other indicators*
- *The possible opportunities for individuals and businesses in view of a looming recession*

Planning is essential during good times but planning for a recession and its corresponding opportunities is imperative. This introduction covers the basics, followed by more detail in the subsequent sections.

01 What Is A Recession?

Everyone is interested in a glimpse into the future, wondering when the next recession will hit, but when it comes to recessions, you can learn a lot by looking at the past. Recessions have broad, sweeping effects on the economic/consumer climate. It's important to note that recessions are part of the economic cycle: They are necessary as part of a cycle of expansion and contraction. If you're prepared, a recession can present planning opportunities.

The general definition of a recession is two consecutive quarters of negative Gross Domestic Product (GDP) growth. This definition was first used in a 1974 New York Times article from the head of the Bureau of Labor Statistics, who also suggested several other measurements. The National Bureau of Economic Statistics (NBER) defines an economic recession as: "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." NBER is the authority on recessions, especially on defining their beginning and ending.

Recession versus Depression. A Depression is an extended, severe recession that lasts longer (3-4 years) and includes a GDP decline of 10% or more. Most of our minds go immediately to the Great Depression of the 1930s as the worst economic contraction. To be sure, the Great Depression (which warrants capitalization) saw the GDP decline between 1929-1933 by 33% and unemployment soar to 25%. What most people don't know is that the recession of 1920 was nearly as deep, and the descent much faster, which is why the Roaring 20s were roaring: they roared out of a big hole. We had a doozy of a depression in 1837 when the Bank of England raised interest rates, which set off a crisis in lending

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and the country sank into a prolonged depression that lasted until 1843. The California Gold Rush helped bring an end to the Great Depression of 1837 by boosting the US gold supply. The all-time award winner for depressions is the 'General Crisis' of 1640. During this stretch, wars, inflation, population declines, and revolts marked one of the most disruptive periods of history and included the temporary disappearance of the government of Poland and the fall of the Ming Dynasty.

Recession alphabets. Economists have a penchant for letter metaphors, especially as they apply to recessions. They often describe the contour of a recession and its recovery with a corresponding letter shape. We could have a 'V-shaped,' 'W-shaped,' 'U-shaped' or 'L-shaped' recession. I'll even suggest a 'J-shaped,' which would be a preferred format.

A 'V-shaped' recession looks like a letter V and is recursive. GDP goes down and recovers at the same relative slope. The recession of 1990-91 was V-shaped. V-shaped recessions are like tossing a ball. If the ball bounces back up at a similar angle, there is symmetry. The V-shaped recession is the type of recession we most commonly encounter.

A 'W' is a 'double-dip,' or a recession with a temporary but failed recovery in the middle. Think of two 'V's with a glimmer of hope in the middle. The recession of 1980-1982 was a W-shaped recession. Some of us can remember the inflation and interest rates of the 80s when the air traffic controllers were fired, and mortgage rates were above 10%.

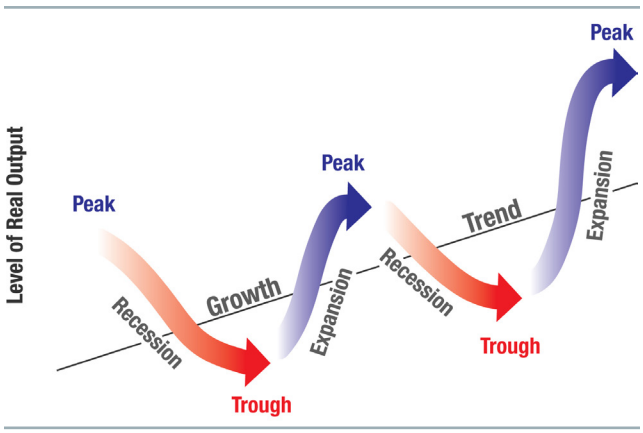
A 'U' is when the economy goes down and stays down. The best example of this was the 1973-75 recession when inflation was running hot and oil prices spiked. I remember the gas lines. People with even numbered license plates able to buy gas on one day and odd numbered plates on another. I once ran out of gas in the gas line.

An 'L' is ugly: it goes down and stays down. This shape is best exemplified by the asset bubble in Japan during the 1990s, where the Japanese GDP dropped and stayed down. I find it ironic that the essay 'The Japan that can say No: Why Japan Will Be First Among Equals' was published in 1989, just as Japan's GDP declined about 20%. Real wages remain below 1997 levels.

There could be other letters. If Japan's experience could be classified as an 'L,' we could call Australia a 'J.' A 'J-shaped' recession would be a case of a downturn that doesn't just recover, it morphs into a period of growth. Australia has enjoyed a 27-year upswing. If recession is a natural part of the economic cycle, this might just be the preferred shape.

Recessions are natural. Recessions are a natural part of the business cycle. If we accept the value of a market-based economy, then we also have to accept the reality of the business cycle. A market-based economy is like a natural eco-system: there is competition and evolution. The business cycle arises out of this competition: competition for profits by businesses, competition for jobs by labor, and competition for capital from banks and investors. So, as the diagram below illustrates, we have expansion, a peak, contraction, then a trough.

Figure 1: The Business Cycle



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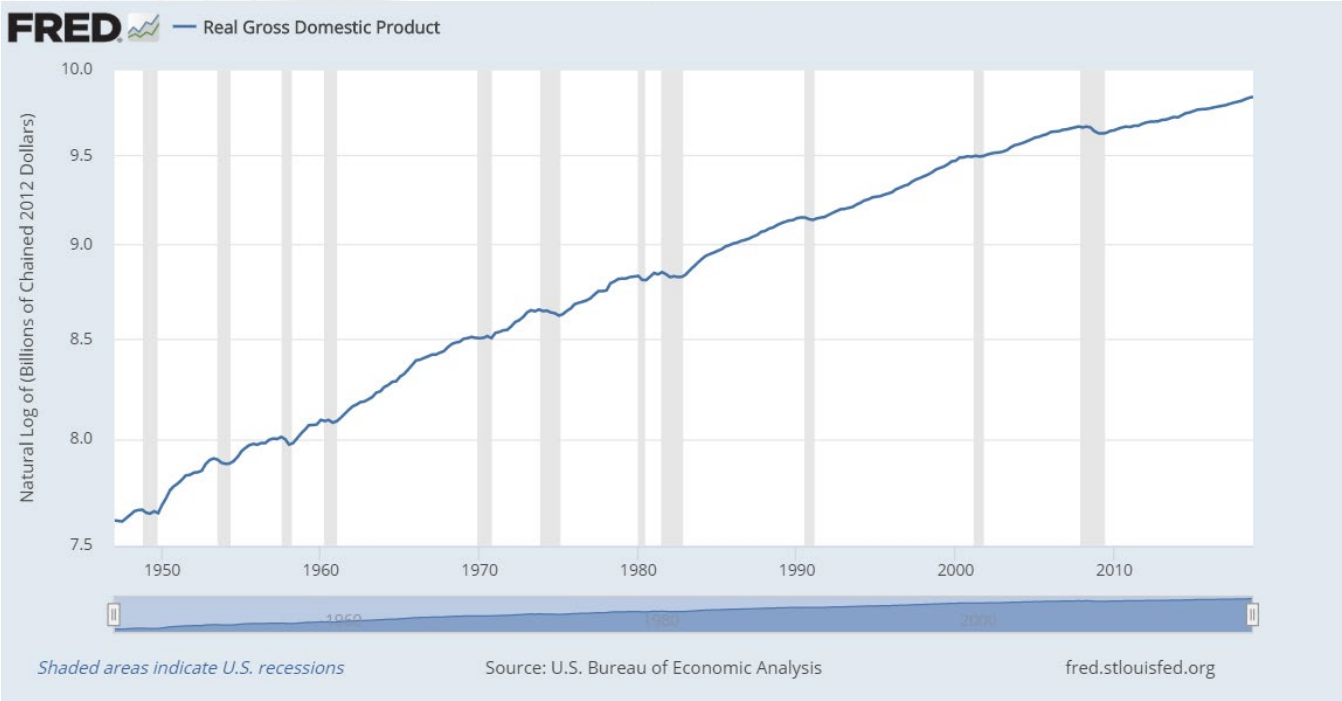
This can be viewed as well through US economic history:

Figure 2: Real Gross Domestic Product (GDP)



This chart is from the Fed, and they graciously have shaded prior recessions in grey. You can see that since 1949, there have been 11 contractions of the US economy.

It should also be apparent that the experience of recession is fiscally uncomfortable, but in the long run, they don't appear malignant to overall growth. The average length of the 11 contractions is 3.6 quarters, with the longest (and most severe, '07-09) at six and the shortest at two consecutive quarters. The average GDP decline for the 11 prior recessions was about -1.9% GDP, with the most severe ('07-09) at -4% and the mildest ('69-70) at -0.2%. The probable causes of 10 of the prior 11 were overly aggressive Fed policy (5), commodity spikes (5) and extreme valuations (4). Some recessions had multiple prospective causes ('07-09, '90-91 and '80).

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Figure 3: Post WWII Recessions

	Recession				S&P Sell-Off			Macro Environment		
	Peak Q	**Trough Q**	**Months**	**% GDP**	**Peak Date**	**Trough Date**	**% Decline**	**Commody Spike**	**Aggressive Fed**	**Extreme Values**
‘49	4Q48	4Q49	11	-1.5%	6/15/48	6/13/49	-21%			*
‘53	2Q53	2Q54	10	-2.4%	1/5/53	9/14/53	-15%			
‘58	3Q57	2Q58	8	-3.0%	8/2/56	10/25/60	-22%			*
‘60-61	2Q60	1Q61	10	-0.1%	8/3/59	10/25/60	-14%			*
‘69-70	4Q69	4Q70	11	-0.2%	11/29/68	5/26/70	-36%		*	
‘73-75	4Q73	1Q75	16	-3.1%	1/11/73	10/3/74	-48%	*		
‘80	1Q80	3Q80	6	-2.2%	2/13/80	3/27/80	-17%	*	*	
‘81-82	3Q81	4Q82	16	-2.5%	11/28/80	8/12/82	-27%		*	
‘90-91	3Q90	1Q91	8	-1.4%	7/16/90	10/11/90	-20%	*	*	
‘01	1Q01	4Q01	8	-0.4%	3/24/00	10/9/02	-49%	*		*
‘07-09	4Q07	2Q09	18	-4.0%	10/9/07	3/9/09	-57%	*	*	
Average			**11**	**-1.9%**			**-30%**			

Source: FactSet, NBER, Robert Shiller, Standard & Poor’s, J.P. Morgan Asset Management. The related market return is the peak to trough return over the cycle. Periods of “Recession” are defined using NBER business cycle dates. “Commodity spikes” are defined as movement in oil prices of over 100% over an 18-month period. Periods of “extreme valuations” are those where S&P 500 last 12 months’ P/E levels were approximately two standard deviations above long-run averages or periods where equity market valuations appeared expensive given the broader macroeconomic environment. “Aggressive Fed Tightening” is defined as Federal Reserve monetary tightening that was unexpected or significant in magnitude. *Guide to the Markets* – U.S. Data are as of September 30, 2018.

Stock markets were adversely affected by each recession, with an average decline of about 30%. In 10 of 11 cases, the stock market peak preceded the economic peak. Similarly, the stock market trough preceded the economic trough in 8 of 11 cases.

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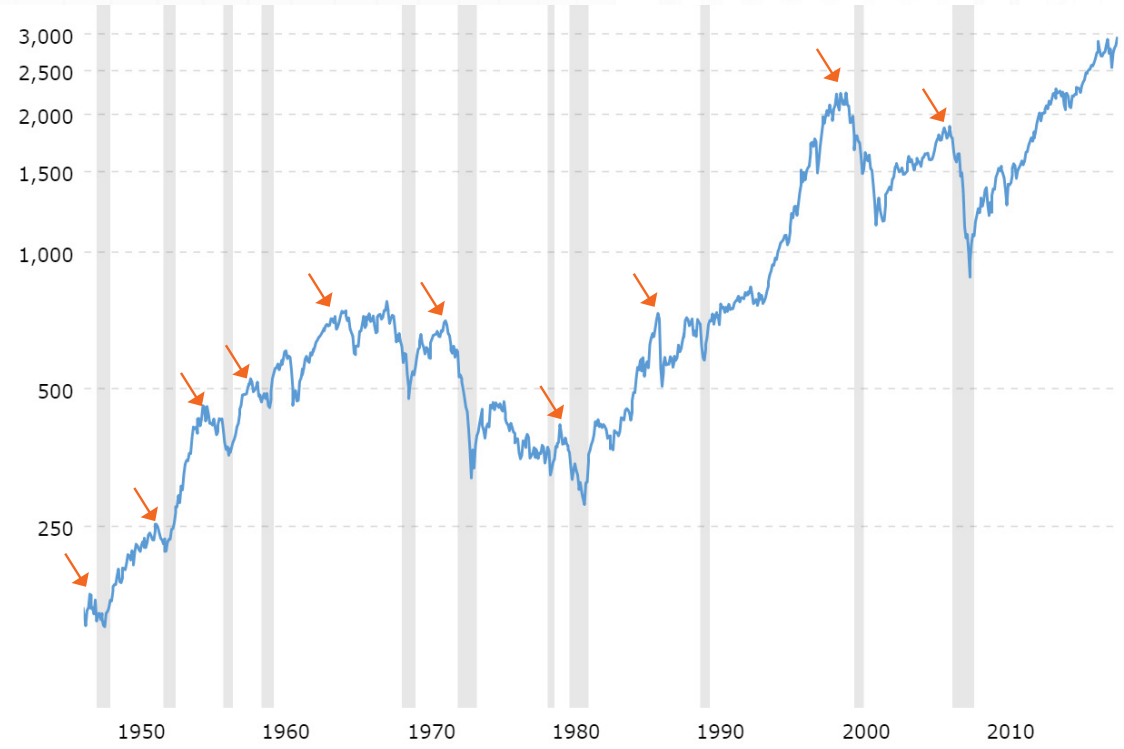
Figure 4: S&P 500 price 1949-2019, log scale, inflation-adjusted



Source: macrotrends. (arrows added for emphasis)

Recessions are bad…and good. The first thing we should note from the history lesson is that recessions are inevitable, and all prior recessions ended and were followed by the continuation of the cycle. We can dread recessions, but they can have a silver lining. Let's look at the negatives first. Recessions usually share specific characteristics:

- Business activity slows
- Unemployment goes up
- Capital expenditures go down
- Credit tightens
- Inflation goes down
- Short term interest rates go down

All these things sound negative, but consider:

- If business is bad, our competition is weakened, hopefully, weaker than us
- If people are looking for work, employers can more easily find quality candidates
- If no one is buying, prices go down on our CAPEX purchases
- If credit gets tight, we can be glad we secured it before we needed it
- If inflation and rates go down, our money will go further, and we'll be glad we have cash on hand

Recessions are opportunities. The tightening will be painful, but recessions can have a very pleasant aftermath. Instead of hiding from the reality of recession, we might employ a bit of foresight and planning. We can work toward seizing the opportunities a recession presents. Just as surely as the economic cycle will present times of decline and contraction, growth will come again. Capitalizing on the opportunities presented during a recession will have us poised and ready when the upswing begins.

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02 Trigger Symptoms

Prior recessions exhibited specific symptoms:

1. A decline in the S&P 500.
2. An inversion in the spread between the 2-year and 10-year Treasury (or other short-term treasury rate and the 10-year).
3. Troughs in the unemployment rate and jobless claims.
4. The unemployment rate minus inflation.
5. Fed policy of increasing interest rates.

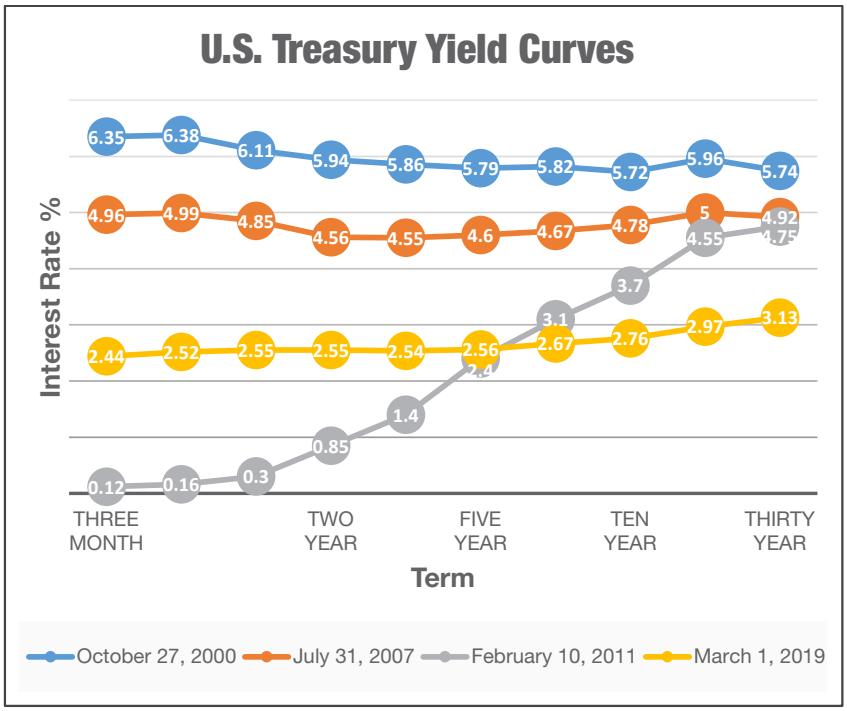
Indicator 1: Market Decline

The stock market is a leading indicator of a pending recession.

Indicator 2: Yield Curve Inversion: What does it mean?

The yield curve is a well-established indicator of an impending recession.

What is the yield curve? Simply stated, the yield curve is a graph that plots the interest rate yield on bonds (of equal quality) over varying maturities. Most of the time, the shorter maturities have a lower yield than the longer maturities. This makes sense since investors usually want a higher return in exchange for tying up their money for a more extended period. In recent history, investors have wanted about 1% (100 basis points) more from a 10-year Treasury than a 2-year Treasury. It's a reasonable assumption: The longer you put your money out, the more you want in return. Factor in that there's more risk in the longer term: risk of inflation or default (unlikely in a Treasury security). However, yield curves can have as many shapes as the patrons of a health club. A standard yield curve is upward sloping (see 2011 below). A 'flat' yield curve is when long term and short-term rates are about equal (see 2007 below). An 'inverted' yield curve is an indicator of trouble on the horizon when short-term rates are higher than long term rates (see October 2000 on the following chart).



Source: Federal Reserve data

An inversion is when the short-term rates are higher than the long-term rates. There are many types of inversions, but the standard is the 10-year Treasury yield minus the two-year Treasury yield. When an inversion happens, the two-year Treasury has a higher yield than the 10-year. According to James Bullard, Chief of St Louis Fed, the inversion tends to be a harbinger of prospects for lower long-term growth and lower inflation. An inversion can mean that investors see more risk in the short term than the long term. It also is an indicator of a disconnect in the outlook between the Fed and the market.

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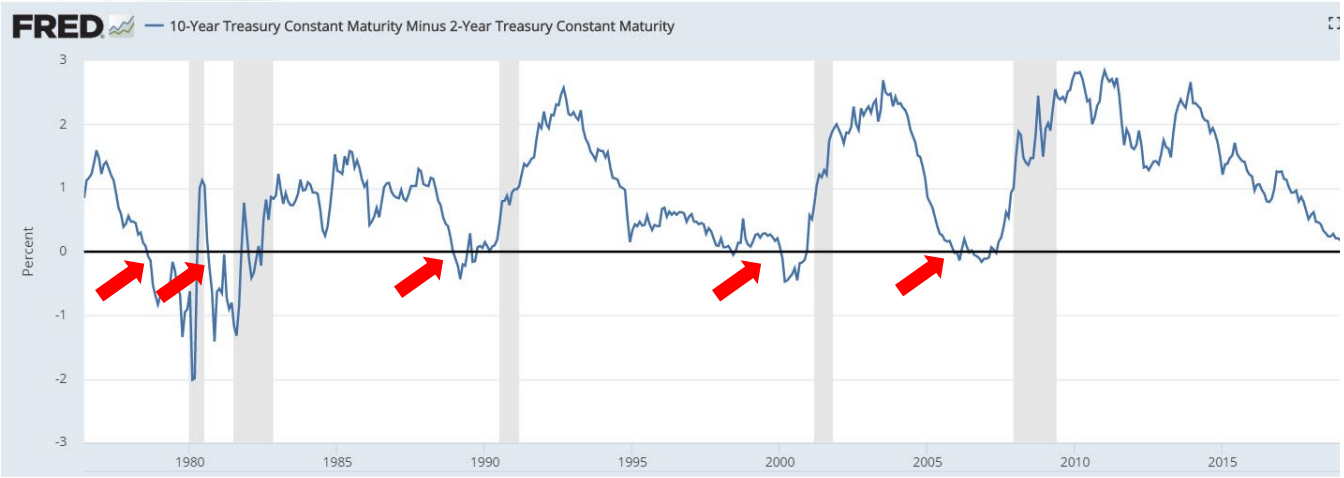
Is an inversion a predictor of a recession? In general, an inversion is a good predictor of lower growth and a subsequent recession. Consider the following chart from the Fed:



Source: Federal Reserve Economic Data

Since 1978, we've seen the following inversions and subsequent recessions:

Date of Inversion	Start of Recession	Number of Months
09/17/1978	01/02/1980	15.5
09/12/1980	07/01/1981	10
08/11/1989	07/01/1990	11
02/02/2000	03/01/2001	13
02/01/2006	12/01/2007	22

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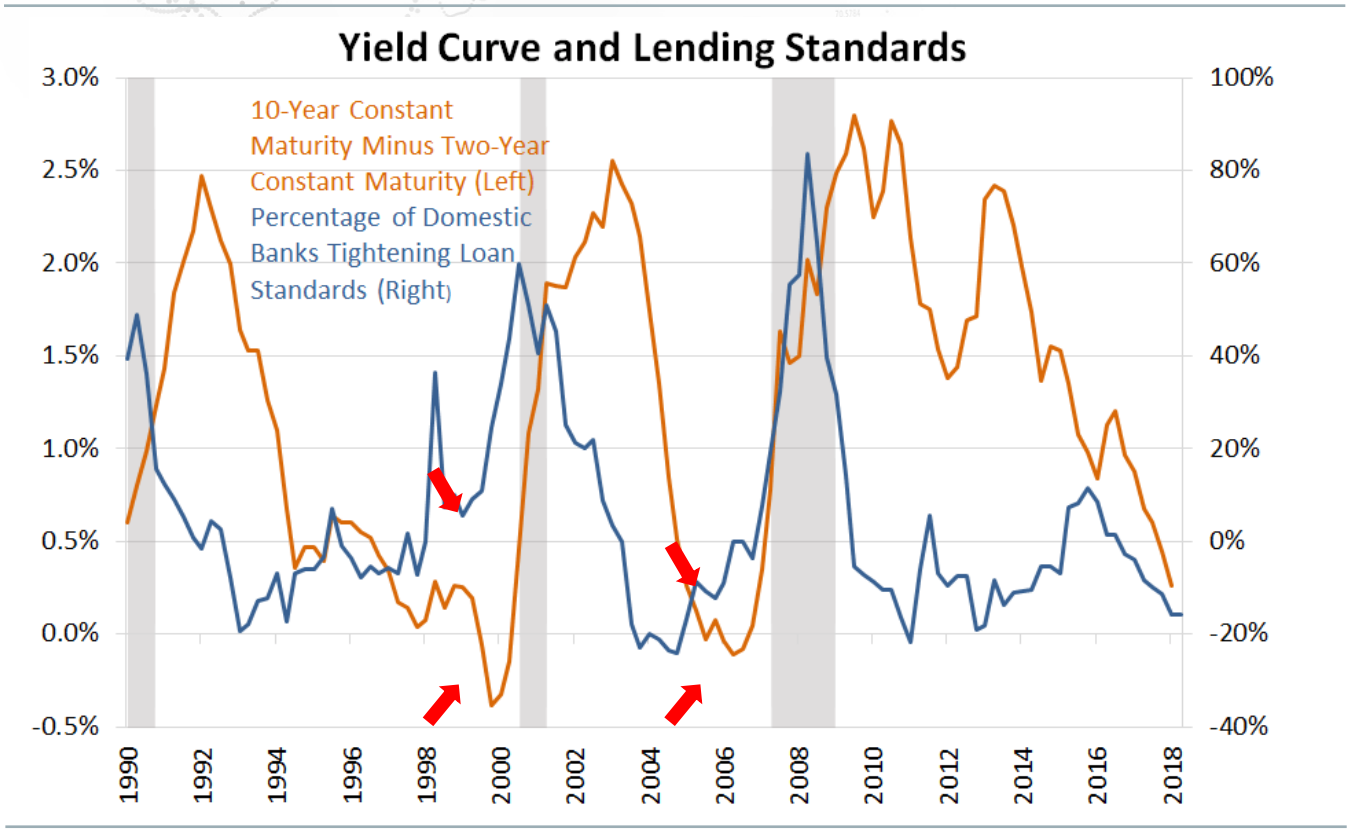
Does an inverted yield curve cause a recession? In a recent Fed blog, David Wheellock shared the Fed's survey of commercial lenders and how lenders tend to tighten credit standards after an inversion. He shares the following chart:



Source: Federal Reserve Bank of St. Louis. FRED (Federal Reserve Economic Data).
Note: Loan standards refers to commercial and industrial loans.

The chart shows that credit tightening tends to run commensurate with the inversion. As the blog also indicates, lenders indicated their reasons for tightening credit in an inversion included:

- Loans become less profitable when short-term rates are higher
- Banks' risk standards become more stringent
- An inversion may signal a less-positive economic outlook

Does an inversion cause a recession, or does an inversion cause banks to tighten lending, which then creates a recession? Is an inversion the indication of a weak economy, or is the inversion a self-fulfilling prophecy? If so, does a tightening by the Fed cause the inversion and thus cause the recession? These are all critical questions, and the subject deserves more analysis. Continued study will aid us in drawing the right conclusions.

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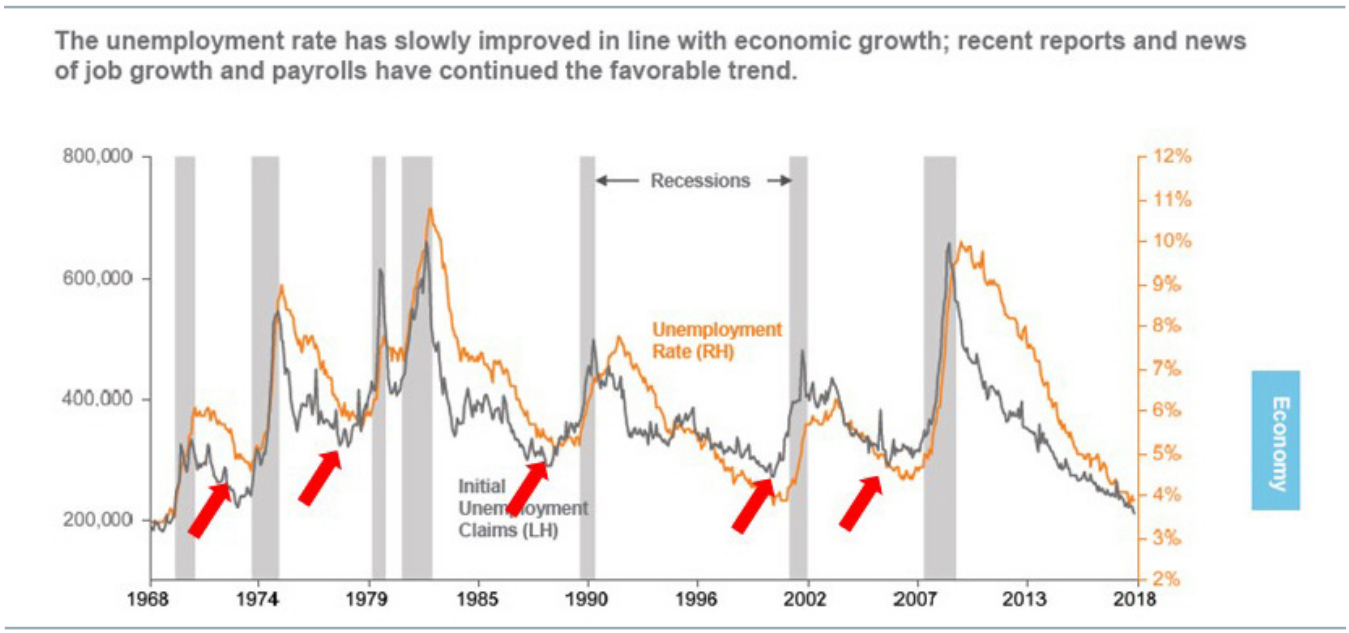
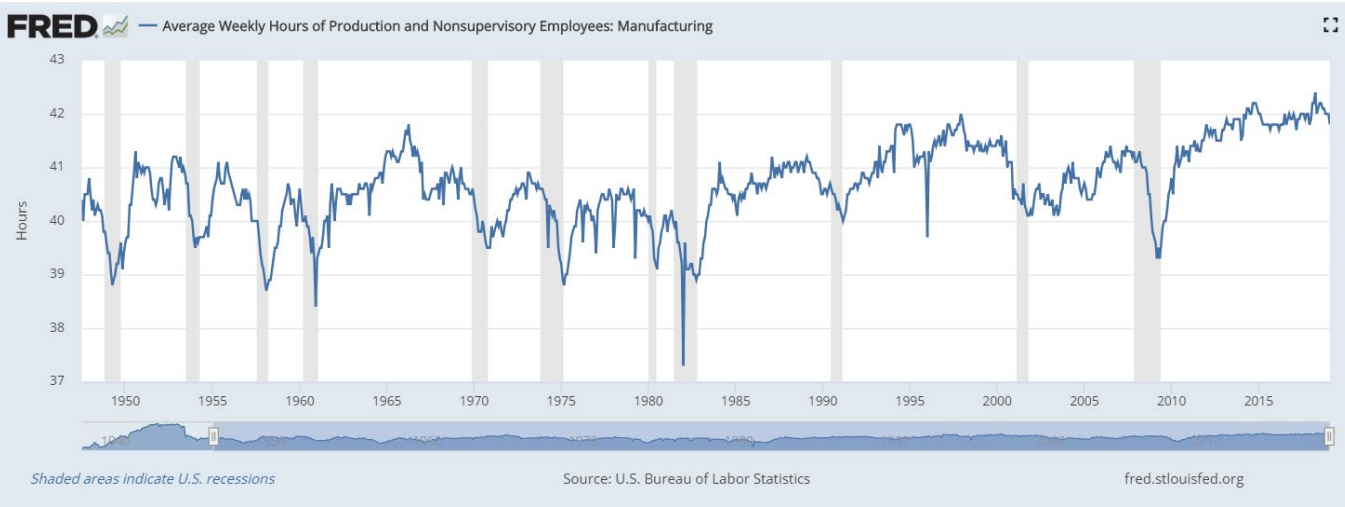
Indicator 3: Unemployment and Recessions

There is a correlation between the unemployment rate and subsequent recessions. The peak of the economic cycle is consistent with full employment. The chart below shows the unemployment rate and jobless claims over time. Note that recessions follow troughs in unemployment.



Source: Bureau of Labor Statistics, FactSet. Initial unemployment claims as of 08/31/18 and unemployment rate as of 08/31/18.

Another relational indicator is average weekly hours. Below is a Fed chart on average weekly hours in manufacturing. Note the hours peaking prior to the recessions.



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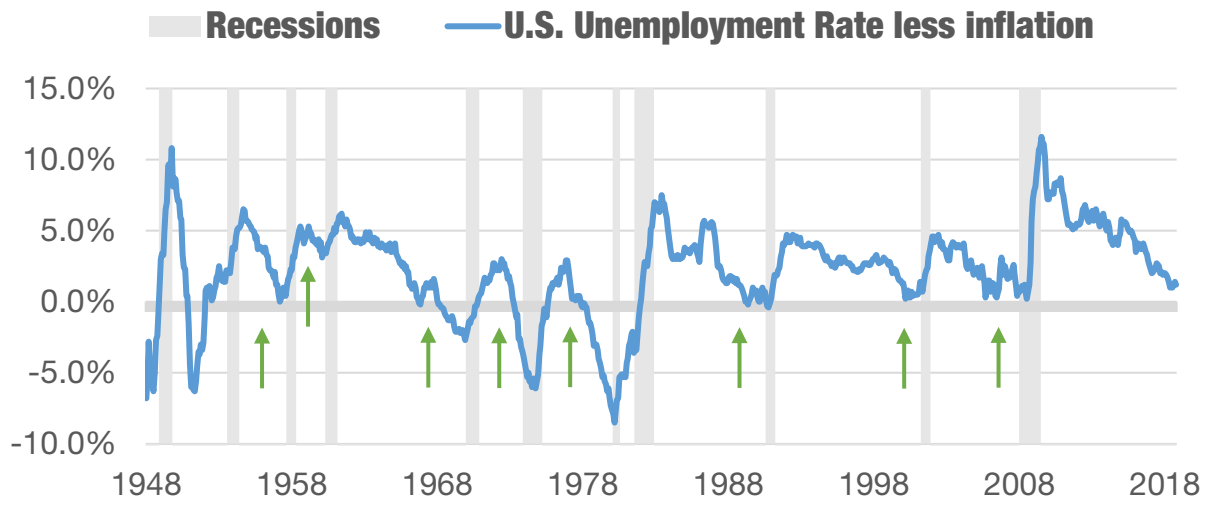
Indicator 4: Unemployment Rate Minus Inflation Rate

Jeff Kleintop of Schwab made an interesting observation. Kleintop noted that a drop in the spread of unemployment versus inflation was an indication that the economy was reaching full employment, with inflation. The chart seems to indicate that his observation has historical merit.



The logical conclusion is that wages and inflation are related. Note in the charts the driver (unemployment rate less inflation), precedes a recession. The indicator: when unemployment minus inflation approaches zero we see high inflation and low unemployment. Both are prospective markers of high labor costs and a 'heating' economy.

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Indicator 5: Fed Funds Rate Tightening

The chart below is a summary of the prior 11 recessions and the Fed interest rate hiking pattern, by date, that tended to precede the recessions. We have had three 'soft landings' in the last 100 years, where the Fed tightened and subsequently loosened and averted a recession. The data tell us that in 10/13 credit tightening cycles, we have had a subsequent recession.

	Recession			Fed Hikes		
	PeakQ	**Trough Q**	**% GDP**	**First Hike**	**Last Hike**	**Result**
'49	4Q48	4Q49	-1.5%			Recession
'53	2Q53	2Q54	-2.4%	Oct 51	May 53	Recession
'58	3Q57	2Q58	-3.0%	Oct 55	Aug 57	Recession
'60-61	2Q60	1Q61	-0.1%	Sept 58	Sept 59	Recession
'69-70	4Q69	4Q70	-0.2%	Nov 67	June 69	Recession
'73-75	4Q73	1Q75	-3.1%	Apr 72	Sept 73	Recession
'80	1Q80	3Q80	-2.2%	May 77	Mar 80	Recession
'81-82	3Q81	4Q82	-2.5%	Aug 80	Dec 80	Recession
'90-91	3Q90	1Q91	-1.4%	Jan 87	May 89	Recession
'01	1Q01	4Q01	-0.4%	June 99	May 00	Recession
'07-09	4Q07	2Q09	-4.0%	June 04	June 06	Recession
				Dec 15	???	???

Soft Landings: Can the Fed Nail One? In aviation, a soft landing is when the aircraft comes back to earth intact. A hard landing is when it returns to earth, unfortunately not unscathed. In the economic cycle, we know what a 'hard' landing is: it's a recession. It's a period of time during which the economy reverses direction. A soft landing occurs when growth slows without a negative GDP. Soft landings are rare; exactly how many there have been is debatable. In recent memory, there is one clear-cut instance of a soft landing in 1994, and another in 1984.

Tightening versus Loosening: The mission of the Fed is to "foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems." Before the 2008 crisis, the Fed did so primarily by changing the Fed funds rate. The broad concept is when an economy is accelerating, too much activity creates excess inflation, and excess inflation destabilizes the monetary system. If the Fed judged the economy was 'heating up,' they could raise rates and slow down the economy to avoid inflation. In the last 11 recessions (post-WWII), the Fed raised rates, or 'tightened' prior to each recession. Some would say that the Fed 'overtightened' and drove the economy into the recession. In each case, and most times before the recession hit, the Fed lowered rates in an effort to avoid recession.

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Too much torque? If you look at the chart above (from the Fed, the arrows are mine), you can see the Fed funds rate (blue line) increase before the recessions in the gray. The 10-year minus the 2-year, or my favorite inversion indication, is in brown. When the brown line dips below zero, the short-term interest rates are higher than the longer-term rates. Note that in every instance of recession since 1978, it was preceded by an inversion. If we included more historical data in this chart, we would observe a pattern. Inversions precede recessions (by an average of about 12-18 months). Upon closer inspection, it can also be noted that the fed raises the fed funds rate (blue line) prior to the inversion (when the brown line dips below 0).

The ugly 1980-1982 'W-shaped' recession shows the Fed Funds rate going from about 4.6% at the beginning of 1977 to 17.6% (!) in early 1980. I've placed a red arrow to indicate an inversion. Looking at the inversions and fed conduct afterward:

- In September of 1978, the yield curve inverted, and the Fed Funds rate was 8.45%. The Fed continued to raise rates in that time frame, and by March of 1980, the recession officially started, the Fed Funds rate was 17.19%. The Fed cut rates through the recession, then raised them again, prospectively contributing to the nasty 'W' recession of 1981-82.
- In August of 1984, we have a soft landing. The yield curve does an 'almost' inversion, and the Fed begins cutting rates immediately. Fed rates go from 11.64% down to 5.85% in September of 1986. Possible result: the 'almost' recession of 1985.
- The Fed begins raising rates again in October of 1986. The 10-2 inverts again in January of 1989, and the Fed raises rates until April of 1989. They then begin lowering rates, but we fall into recession in August of 1990.
- In December of 1994, we see what may be the best example of a soft landing. In December of that year, the 10-2 is close to inversion, and the Fed Funds rate goes up about 60 bps. The Fed responds by gently lowering rates. Again, a recession is averted by carefully orchestrated Fed moves.
- In February of 2000, there is another 10-2 inversion. The Fed continues to raise rates, from 5.73% to 6.53%. The Fed starts to lower rates in December of 2000, but we have a recession by April of 2001.
- Most recently, there was a 10-2 inversion in March of 2006. That inversion hovers around the zero point until May of 2007, while the Fed continues to raise rates and then hold them steady. The Fed starts cutting rates in June of 2007, but to no avail. The U.S. Economy enters a significant recession by January of 2008.

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What of prior soft landings? In instances of successful soft landings, the Fed acted very quickly to cut rates. In hard landings, the Fed generally continued its interest rate course past the warning signs and cut rates too late. In every case, the Fed did lower rates during the recession. It appears that the sooner the Fed cuts rates, the less likely the recession. How soon is soon? In the two soft landings we looked at, the Fed reversed course within a few months surrounding the inversion. As shown earlier, in all the post-WWII recessions, the Fed has tightened rates before the recession.

Two tools, not one. A difference between the past and our present situation is that the Fed now has two tools with which to affect change. They have historically modified short term rates by changing (lowering) the Fed Funds rate. The Fed has a new tool; they can also adjust the number of government bonds on their balance sheet. As of March of 2019, the Fed was letting $30-50B a month of Bonds and Mortgage Backed Securities (MBS) 'run-off,' or expire from the balance sheet. In its March 20, 2019 release, the Fed announced it would reduce the run-off from $30B to $15B in May of 2019 and stop the reduction in September of 2019.

03 Recession Opportunities

Back Story: Sometime around 1981, I was working at a large CPA firm. We were in the throes of a massive W-shaped recession. Interest rates had skyrocketed, and unemployment was rampant. The managing partner was exceptionally chipper one day; I asked him why given this deep recession. He answered, "Recessions are opportunities: they change how people think and act, and if you do it right you can thrive in them."

He took me to a client's tool shop. The parking lot was full, and a friendly receptionist greeted us with a smile. No one was working at their desk, and as we went through the shop, I noticed it was empty as well. It was empty, but it was spotless: the floor was perfect, the machines were painted, the tools sharpened, the lockers were freshly painted with neat name tags on the doors. The overhead doors were open, and outside, a whole group of people were playing full-court basketball in the parking lot. I asked what was going on.

The managing partner pointed to a guy, a bit older than the rest. When the game slowed down, he introduced me to the owner. "He (nodding to the MP) taught me that recessions were opportunities. When this downturn happened, I made cuts to my payroll, got rid of the dead wood. Then I had my crew clean the shop, and when that was done, fix up the locker room, and then we built this court. Now we play hoops, get in shape and plot world domination." I asked if he thought his plan would work. "See that guy?" pointing to a big fellow at a picnic table. "He's laid off from my competitor. He's a fantastic young tool guy, tons of potential; he'll be a huge asset to my team. I made room on my payroll for guys like him. When we get back to business, he'll be playing for the right team."

When the recession ended, as they all do, this client's business quadrupled. He had seized the opportunity.

We're in the second longest (by July '19, the longest) expansion in US history. Sooner or later, the economic cycle will bear itself out, and we will have a slowdown. If we have a recession coming, what can we do? Recessions are opportunities: opportunities to hire, buy, invest, and compete. Easy times make for easy competition. Hard times make for hard competition. Here are some observations:

- Interest rates usually rise
- Credit tightens
- The yield curve normalizes (long-term rates move higher than short-term rates)
- Credit spreads widen. High-yield defaults increase.
- Stocks fall before a recession

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- Value usually prevails during and after
- The consumer staples sector usually holds-up better than other sectors while the technology is often the worst hit
- Unemployment goes up
- CAPEX goes down
- Advertising spending goes down
- Competition weakens

Recessions are like winters: we know they are coming, and they are more comfortable when you're prepared. Given what we think will happen when there is a recession, here are some ideas.

Business Ideas

1. **Do a business gut-check.** Do an overview of all finances. Income statement, balance sheet, and cash flow. What is good. Where do you see risk? If you're a business owner, consider how this business risk will impact your personal financial situation. Do you have enough cash to support your personal needs? Can you contribute personal resources to the business to weather the storm? How significant is your personal and business debt? Is this a good time to refinance and extend terms?
2. **Lean up.** Lean-up budgets. Dump useless stuff now. Ask yourself, "If I didn't have "X," would I hire/purchase it now?" If the answer is no, it should be trimmed.
3. **Have dry powder.** It's important to have cash reserves to get you through the downturn, plus have funds to deploy for expansion.
4. **Check credit lines.** Check your credit and lines of credit. Get business loans lined up before a downturn. Consider pulling out some cash early.
5. **Consider waiting on large purchases** (Capital Expenditure CAPEX). In recessions, prices tend to go down, and companies are more eager to sell, meaning deals and discounts abound. In addition, sadly, many companies go out of business and have assets for sale making a recession a great time to buy. Consider delaying significant expenditures until the downturn. Be an opportunistic buyer.
6. **Competition.** In a downturn, many businesses are unprepared. Seize this opportunity to buy them out, hire their employees, or advertise when they stop.
7. **Look for new ideas.** The best time to do a start-up is in a downturn. Good people are out of work, companies have folded or sold off divisions, and there are opportunities in technology and product expansion.
8. **Build and protect the team.** Bring your team together and ask for their ideas. Be transparent; rumors can kill a business. Do your best to keep all of your 'A' players, even if they are painting the shop room floor or setting up a basketball hoop in the parking lot. Somebody will survive the recession, and it may as well be you!

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Individual Ideas

1. **Do a gut-check.** Do an overview of your personal finances. Income statement, balance sheet, and cash flow. Look for: unnecessary debts; loafing assets (like low- interest checking accounts); orphan IRAs/401(k) plans, etc.
2. **Lean up.** Lean up your personal budget. Get rid of useless stuff now or wasteful personal spending, like unused subscriptions and memberships. Set a 'need' versus 'want' criteria for expenditures. Consider resetting the budget to reflect only regular income instead of including bonus or overtime pay.
3. **Have dry powder.** It's important to have cash reserves to get through the downturn, plus have funds to deploy for investing. Shoot for 3-6 months of monthly expenses in a money market account.
4. **Check borrowing.** Check your credit score and lines of credit. Get home equity lines of credit limits up before a downturn. If you are thinking about refinancing, consider doing it early. Pay down credit cards. Don't cancel the cards; that can hurt your credit and dries up a source of cash.
5. **Consider waiting on large purchases.** As previously mentioned, in recessions, prices tend to go down, and your home is included. If you are downsizing, it may make sense to sell now and buy later. Are you buying a bigger house? Logic would say wait until you see how the recession impacts your cash flow.
6. **Investing.** In a downturn, prices are down, and the sale is on. Resist the temptation to bail out of equities. Every recession so far has been followed by a recovery. Since every prior recession has had an accompanying market decline, there will be buying opportunities. Look for assets and asset classes that are undervalued.
7. **Sharpen the skill saw.** Downturns are a good time to learn a new skill. Take a coding class or learn a new skill online. Sharpen your language skills. When hiring resumes, you'll have more to offer.
8. **Build your network.** Downturns can change relationships at work or in business. Make it a point to get to know more valuable contacts and to amplify your existing connections. You may be able to help or connect someone or have them help or connect you to someone who may be a valuable acquaintance.

Bottom Line: History bears witness to the phases of the business cycle. There is a well-established pattern of expansion, peak, contraction, and trough. It isn't coincidence; it's the life cycle of our economy.

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Recession Opportunity Kit

Recession Opportunities for Businesses

Recessions are a natural part of the business cycle. In a declining phase of the economic cycle, jobs are lost, businesses fail, credit tightens, and advertising spending drops. In good times, all types of competitors can prosper. In hard times, the strong survive, and the weak perish. Being prepared means seizing opportunities. The following are ideas for businesses:

1. **Do a business gut-check.** Do a comprehensive financial overview, comparing prior periods (months and years) and trends
    a. Income statement
    Compare costs as a percentage of revenue:
        i. Which costs are controllable?
        ii. Which costs will be affected by a downturn?
        iii. Variable costs versus fixed costs?
        iv. Gross margin, net margin (comparative)
        v. EBITDA? EBOC? (Earning before owner's compensation)
        vi. Return on equity? Return on assets?
        vii. What's the breakeven and how can I lower it?
    b. Balance sheet
        i. Current assets versus fixed assets, year on year, month to month;
        ii. Current liabilities versus long-term liabilities.
        iii. Interest rates on all loans, term of all loans;
        iv. Current ratio? Quick ratio? Debt to equity ratio?
    c. Cash flow
    d. Other KPIs (Key performance indicators?)
        i. Revenue per employee? (full-time equivalent)
        ii. Revenue per work hour?
        iii. Dashboard of information available?
    e. Legal
        i. All filings current?
        ii. All employee contracts current (non-competes, non-solicits)?
        iii. Correct entities for all business lines to minimize taxes and insurance costs?
    f. Risk Management, Insurances, etc.
        i. Insurance review to assess if coverages are appropriate, adequate or excessive.
        ii. Cybersecurity policy needed? Tested and working?
        iii. Video inventory and all assets to document for insurance claims?
        iv. Intangible assets documented and covered?
        v. Excess cash out of the business? (but keep it available as "dry powder, see #3.)

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g. Taxes
    i. Using optimal accounting method?
    ii. Taking advantage of pass-through provisions? Completed an aggregation plan?
    iii. Mindful of new NOL restrictions? Excess loss limitations?
    iv. Optimizing full-expensing provisions?
    v. Considered the interaction of NOL, Excess loss, full expensing and pass-through?

2. **Lean up.** Look for excess spending or wasteful practices.
    a. Lean up budgets. Run a 'Clint Eastwood' budget: the Good, the Bad and the Ugly. 'Ugly' should be a worst-case scenario.
    b. Dump useless stuff now
        i. What don't you need to succeed?
        ii. What has excess capacity?
        iii. What is wasting enterprise assets?
    c. Which are your low-performing employees?
        i. Buy, sell or invest?
        ii. Which employees don't embrace the enterprise's values?
        iii. Who are the bottom 10% of performers? Why?
3. **Have dry powder.** It's important to have cash reserves to get you through the downturn, plus have funds to deploy for expansion.
    a. Based on your budget, what's the burn rate per week?
    b. Under each scenario (Good, Bad and Ugly), what's the burn rate for each scenario?
    c. What might you be able to buy or acquire if competitors go out of business?
    d. Have enough personal dry powder (personal liquid wealth)?
4. **Check credit lines.** In a recession, credit gets tight. As the adage goes, "Only ask the banker for a loan when you don't need it."
    a. Check your credit and lines of credit.
        i. Interest rate?
        ii. Credit terms?
        iii. Covenants or restrictions? Can you meet them during the Good the Bad and the Ugly?
        iv. Collateral?
    b. Get business loans lined up before a downturn. Consider pulling out some cash early.
    c. Create a credit expansion request. Shop banks, garner competition
    d. Consider stripping a bit of capital out of the company
5. **Consider waiting on large purchases (Capital Expenditure CAPEX).** In recessions, prices tend to go down, companies are more eager to sell, and deals and discounts abound. In addition, sadly, many companies go out of business and have assets for sale as well. Consider delaying significant expenditures until the downturn is over.
    a. What is your CAPEX budget?
    b. What is the effect of delaying purchases by a month? A quarter?
    c. What is the % cost of delay? How much discount do we need to justify waiting?

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6. **Competition.** In a downturn, many businesses are unprepared. Seize this opportunity to buy them out, hire their employees, or advertise when they stop.
    a. Who are your competitors?
    b. Rank them by size, by employees, by enterprise health, by reputation?
    c. Strengths? Weaknesses?
    d. Run a Google search on them. Consider a Google Alert to see what's going on in their businesses.
    e. Chinks in the opponent's armor? Are they losing employees (watch and monitor competitors on LinkedIn)? Losing contracts?
    f. Look at ad spend? Seem to be decreasing? Increasing?
7. **Look for new ideas.** The best time to do a start-up may actually be in a downturn.
    a. Who are the people involved in new ideas?
    b. What companies have shut down lines or locations?
    c. Check LinkedIn to see who is available. Look at local TedX.
    d. What business incubators are in your area? Who's thriving there?
    e. What's the latest in technology? Who's using it? Any competitors using it? Who works there?
8. **Build and protect the team.** Bring your team together and be transparent on the situation. Do your best to keep all of your 'A' players, even if they are painting the shop room floor, or setting up a basketball hoop in the parking lot. Somebody will survive the recession, and it may as well be you!
    a. Who's your 'A' team?
        i. How happy are they?
        ii. How likely are they to jump?
        iii. What's their 'deal breaker'?
        iv. What's their pain point?
    b. Who's your 'C' team? Why do you have them?
    c. Does everybody know the mission, vision, and values of the enterprise?
    d. Is everybody aware of the plan?

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Recession Opportunity for Individuals

For individuals, a recession is a combination of survival and opportunity. Survival to have the ability to continue without financial hardship; opportunity to make investments or purchases at a better price or terms. Recessions are natural filters that filter out the weak and unprepared. Pre-recession is the time to build a usable financial plan

1. **Do a personal finance gut-check.** Do an overview of all personal finances.
    a. Income statement: What you make, spend and save
        i. Income
            1. Earned, like wages;
            2. Unearned, like interest or dividends;
            3. Retirement income
        ii. Expenses
            1. Variable (they vary with your income)
            2. Fixed (you have to pay them),
            3. Discretionary versus non-discretionary
            4. Inflation factors
        iii. Savings
            1. Tax-deferred (401(k), 403(b) or 457(b))
            2. Tax-free (Roth IRA, HSA)
            3. After-tax
    b. Balance sheet: What you own and what you owe
        i. Assets
            1. Investment assets (saving assets, real estate, cash used for investing)
            2. Non-investment assets (home, vehicles, personal property)
            3. Appreciation rate, holding cost of various assets
            4. Non-productive assets (what's loafing? Get rid of it)
        ii. Debts
            1. Mortgage debt (and HELOC, or other tax-deductible interest debts, like investment interest)
            2. Other deductible-interest debts
            3. Consumer debt (credit cards)
            4. Interest rates, terms
            5. Which debts can be eliminated?
            6. Debt snowball a possibility?
    c. Cash flow: How much you have in hand every month.
    d. Risk management:
        i. All insurance policies up to date and adequate coverage?
            1. Homeowners
                a. Guaranteed replacement?
                b. Replacement cost on contents?
                c. Big enough limit?
                d. Selfie of the contents of the house?
                e. Riders for scheduled property?

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2. Auto
    a. Enough coverage?
    b. Shopped price?
    c. Higher deductible to save costs?
    d. Correct type of deductible?
3. Umbrella (need coverage?)

ii. Valuable papers inventoried and in a safe place?
iii. Inventory of PINs? Safe place?
iv. All insurance policies in a safe place?
v. Important persons (HR person, lawyer, CPA, doctors) listed and list given to your person?
vi. Tax records safe and in a safe place?
vii. Computer security set up?

2. Lean up. Lean up your personal budget. Set up a multi-level budget: the Clint Eastwood: the Good, the Bad, and the Ugly. Good is everything stays the same, Bad is things get 10-20% worse, Ugly is things get 30-50% worse.

a. Dump useless stuff now or wasteful personal spending,
    i. Unused subscriptions
    ii. Unused memberships.
    iii. Nonessential consumer expenditures, like luxury coffee, restaurant meals, and excessive balances on credit card when you have cash, etc.
    iv. Be mindful of utilities and other fixed costs, combat these with common sense solutions, for example, use an effective thermostat, and turn off the lights.
    v. Watch ATM fees.
b. Shop more:
    i. Shop insurances
        1. Homeowners
        2. Car
        3. Health
    ii. Watch the bulk purchase trap
c. Set a 'need' versus 'want' criteria for spending. Do you need it (is it essential?) or do you want it (is it a luxury?)
d. Three-day rule: set a limit on more substantial expenses (say over $100) that you wait three days to purchase it
e. Consider resetting the budget to only regular income, not including bonuses or overtime.
f. Get a notebook and document all your spending

3. Have dry powder. It's important to have cash reserves to get you through the downturn, plus have funds to deploy for investing. Shoot for 3-6 months of monthly expenses in a money market account

4. Look at your borrowing.

a. Check your credit score and lines of credit.
b. Get home equity lines of credit limits up before a downturn.
c. If you are thinking about refinancing, consider doing it earlier.
d. Pay down credit cards. Don't cancel the cards; that can hurt your credit and dries up a source of cash.

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5. **Consider waiting on large purchases.** In recessions, prices tend to go down, companies are more eager to sell, and deals and discounts abound. In addition, sadly, many companies go out of business and have assets for sale as well. Consider delaying significant expenditures until the downturn is over. Houses are included, but if you are downsizing, selling yours and buying smaller, it may make sense to sell first, buy later. Are you buying a bigger house? Logic would say wait.
6. **Investing.** In a downturn, the prices are down, and the sale is on. Resist the temptation to bail out of equities. Every recession so far has been followed by a recovery.
    a. Consumer staples typically do best in recessions, and technology does the worst.
    b. Value tends to outperform growth in recessions.
    c. Short-term bonds and cash allow for deployment into other asset classes.
    d. Rebalancing is a way to keep investing as the market goes down and harvest as it goes up.
    e. Recognize that 'best days' and 'worst days' tend to cluster near each other and bailing out on a bad day may eliminate the opportunity to participate in the upturn. Missing even the best 30 days over 20 years can reduce your overall return to zero. Its 'time IN' the market, not 'timING' the market
7. **Sharpen the skill saw.** Downturns are a good time to learn a new skill. When the hiring restarts, you have more to offer.
    a. Take a coding class or learn online.
    b. Sharpen your language skills.
    c. Determine what skills you need for the next round of your life.
8. **Build your network.** Downturns can change relationships at work or in business. Make it a point to get to know more valuable contacts and to amplify your existing contacts. You may be able to help or connect someone or have them help or facilitate a connection for you.
    a. Consider LinkedIn
    b. Use Facebook
    c. Try Twitter
    d. Participate in networking groups

The Bottom Line: Recessions happen because good times cause bad times and, fortunately, vice-versa. Getting ready for a recession means being prepared. If you knew a storm was coming, you would prepare. To get started, you need a plan. The initial step is to critically review your financial plan with your financial advisor within the context of your current situation, goals, and objectives. This paper will help you create a simple to-do list for future action.

What would you do in early 2000 or late 2007 if you had known a recession was coming? Would you line up credit, keep some cash, track your competition, or sit still and follow the course? The opportunities are there for those who seize them.

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