Quick Glance

Wealth Management

A Tale of Two Cities Rising Interest Rates and the Stock Market

Hardee Investment Group

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With the Federal Reserve starting to raise interest rates, we've been asked how it affects the stock market. According to RBC, every bear market has been accompanied by an inverted yield curve and subsequent recession. Below is our recession indicator scorecard.

RBC's recessionary scorecard

Start of recession	Yield curve	ISM mfg.	Inflation trends	Capacity utilization	Housing starts	Labor market
Dec '69	•	•	•	•	•	•
Nov '73	•	•	•	•	•	•
Jan '80	•	•	•	•	•	•
Jul '81	•	•	x	x	•	x
Jul '90	•	•	•	•	•	•
Mar '01	•	•	•	•	_	•
Dec '07	•	•	•	•	•	_
Present	x	x	_	_	x	x

• Recessionary territory x Expansionary territory _ Neutral

Four of six indicators point to expanding GDP growth; two are neutral.
Source — RBC Capital Markets, Haver Analytics, U.S. Census Bureau, ISM, BLS, Federal Reserve, NBER, S&P

This table illustrates why we believe recession risks are so low, and that is very important for the stock market.

The dates on the left show periods when the past seven recessions began. The columns labeled at the top in dark gray represent market or economic indicators that we believe tend to signal when a recession begins. In six of the past seven recessions, the indicators were overwhelmingly negative. Currently four of the indicators are in expansion territory. Two indicators are neutral. None of them are in recessionary territory.

Why does this matter? Historically, it has been recessions that have killed the golden goose — not elections, low economic growth, changes in corporate earnings trends, and not necessarily Fed rate hikes. It's recessions that matter most for the market. When a recession grips the economy, the stock market almost always moves from a bull market to a bear market. It usually sells off 20% or more, and the bear market can last for a number of quarters.

But when the recession risks are quite low, like now, pullbacks or corrections are usually short-lived and not as acute as the steep corrections that accompany recessions. And when our indicators are positive, the bull market cycle usually stays intact.

That's why when recession risks are low, we think the stock market deserves the benefit of the doubt. The current state of these indicators gives us confidence that recession risks are quite low for the next 12 months, at least. And that the bull market we've been in since 2009 can persist.

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