

## **Recessions Create Lucrative Investment Opportunities**

**Historically, small cap stocks generated 38% returns in the twelve months following recession announcements.**

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On Monday December 1, 2008, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) determined that a recession began December 2007. This committee, made up of renowned economists, is the official source for dating United States recessions. Historically, some of the best investment opportunities occur at or near the time of recessionary announcements.

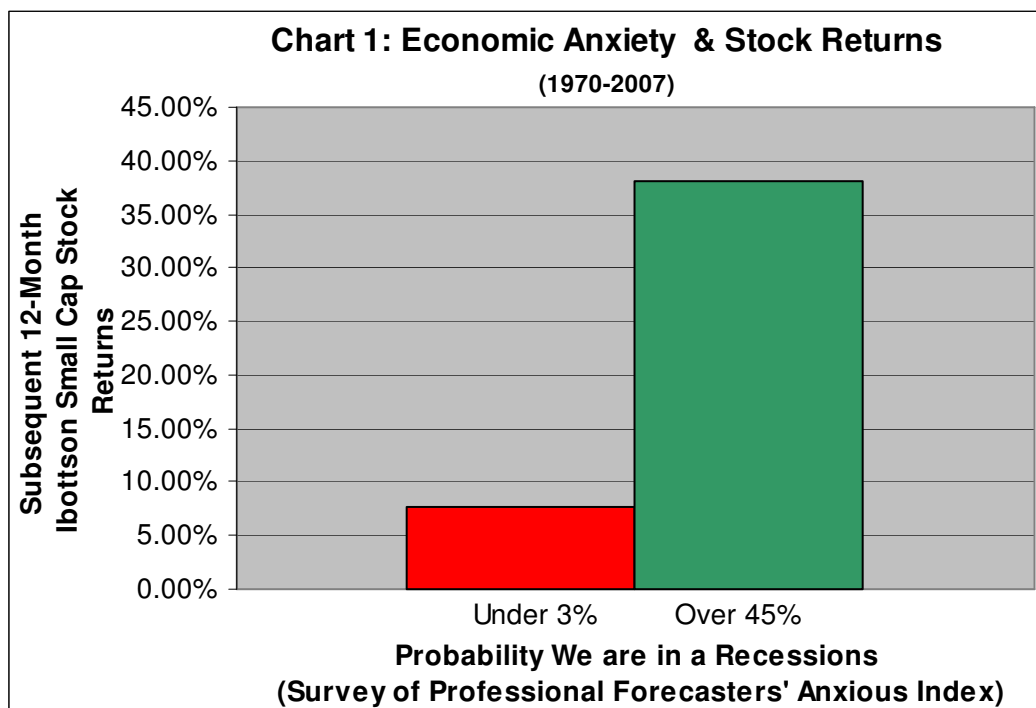
The conventional definition of a recession is two consecutive quarters of decline in real Gross Domestic Product (GDP). However, the NBER uses a more refined definition. The NBER defines a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators".

Since stock prices are anticipatory, they tend to move ahead of economic conditions. Prior to the start of an economic expansion, stocks prices typically bottom 3 to 10 months in advance of an economic turning point. Preceding an economic downturn, the stock market tends to peak at two to three months before the recession begins.

Historically, stocks perform poorly during the first half of economic contractions. This is the period when recessions are not fully recognizable. In contrast, stocks perform well during the second half of economic contractions. The second half of economic contractions is when recessions are generally fully recognized by investors and the media.

The NBER has only been dating recessions in real time since 1980. Therefore, to get a longer term perspective, we use the Survey of Professional Forecasters. This survey is currently managed by the Federal Reserve of Philadelphia.

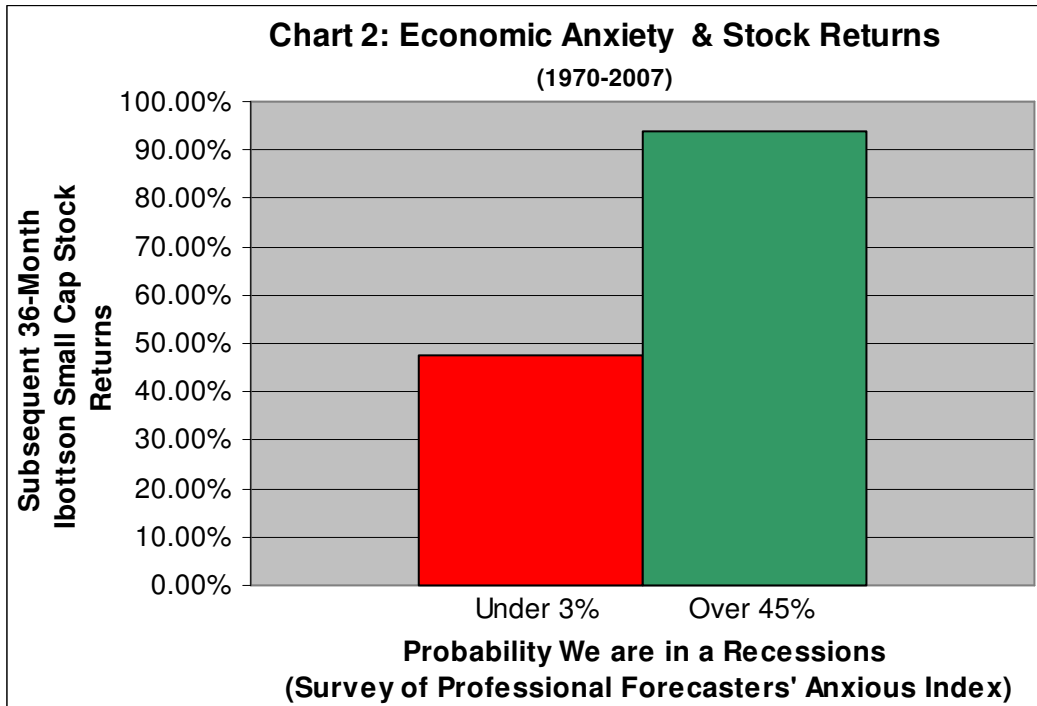
As Chart 1 illustrates, small cap stocks generated outstanding returns in the twelve months following recession announcements. Historically, when investors believed we were likely in a recession, stock prices were frequently bottoming. On average, small cap stocks produced 38% returns in the twelve months following the recognition of a recession.



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In contrast, small cap stocks produced below average returns when market participants perceived only a remote chance of recession. Small cap stocks generated average annual returns of only 7% when market participants believed there was less than 3% likelihood of an immediate recession.

As Chart 2 demonstrates, historically, investors who employed their capital during periods of high economic anxiety were greatly rewarded. Small cap stocks returned, on average, approximately 94% in the three years following recession announcements.



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Looking forward, we believe courage will be greatly rewarded. The fears and anxieties associated with the financial crisis and economic recession have created the best investment opportunities in over 25 years.

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