RiverFront Investment Group

Strategic View

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Why the Recession Call Matters for Stocks

RiverFront Does Not See a Recession on the Horizon

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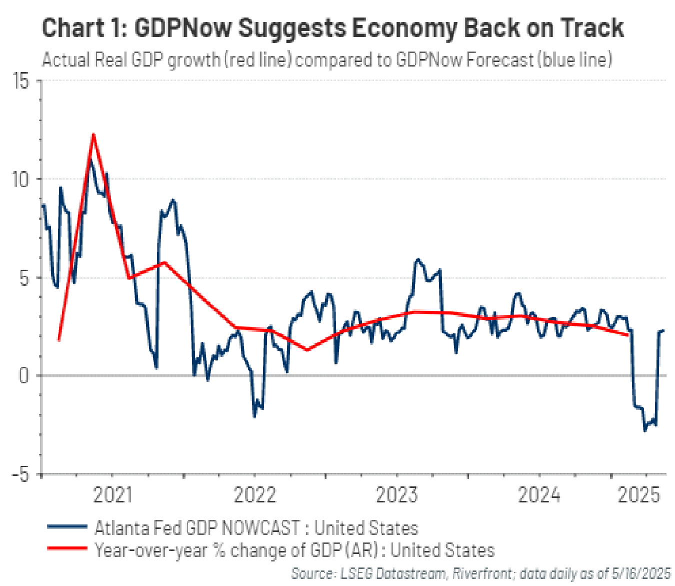
SUMMARY

- Despite trade uncertainty, we do not foresee a recession on the horizon.
- The US economy continues to show resiliency, which we believe matters for the stock market.
- Stock volatility in the absence of a recession generally ends more quickly, and inflicts less damage than recessionary bear markets.

This past week, news flow around policy came in hot and heavy, with President Trump's 'Big, Beautiful' tax cut bill passing the House of Representatives, and Trump threatening 50% tariffs on the European Union (EU). While progress on tax relief was welcome if not sufficient to reignite a stock rally – the bill in some form must still find passage in the Senate – risk markets chose to focus instead on trade tensions, ending the week on a sour note. This back-and-forth on trade is to be expected (note that Trump softened his tone on Europe over the weekend), and fits with the Trump Administration's negotiation style. Trade talks with the EU – a conglomeration of 27 countries with differing sizes, export strengths and incentives – were always likely to be fractious, and we are not holding our breath for resolution before the 90-day 'trade pause' expires.

Despite these headlines, however, we are unlikely to meaningfully shift the probabilities assigned to our four economic outcomes – discussed here – as a result of last week's news flow. We still believe the likeliest outcome is a 'Muddle Through' scenario, whereby headlines stay chaotic in the near-term, but the US is able to reach trade deals with most major trade partners by the 2nd half of the year, and the economy is able to avoid recession in '25. Underneath this 'Headline Hell', **the US economy continues to show considerable signs of resilience, in our view.** Earnings season has been better than expected thus far, inflation indicators continue to moderate, and – importantly – very few of the indicators we track on our 'Recession Dashboard' are flashing red in the US. For instance, the Atlanta Fed's GDPNow activity tracker (Chart 1, right) is currently suggesting the US economy is growing at about a 2.4% annual growth rate after its' brief technical downturn in Q1 (the downturn was related in our opinion to extraordinary pre-tariff trade flows, as discussed here). While 'soft' (survey-based) data appears weaker than 'hard' (evidence-



Source: LSEG Datastream,, RiverFront; data daily as of May 16, 2025. Shown for illustrative purposes only. Past performance is not indicative of future results.

based) data, PMI surveys remain slightly above the 50 level typically associated with economic expansions and employment data continues to be robust, in our view.

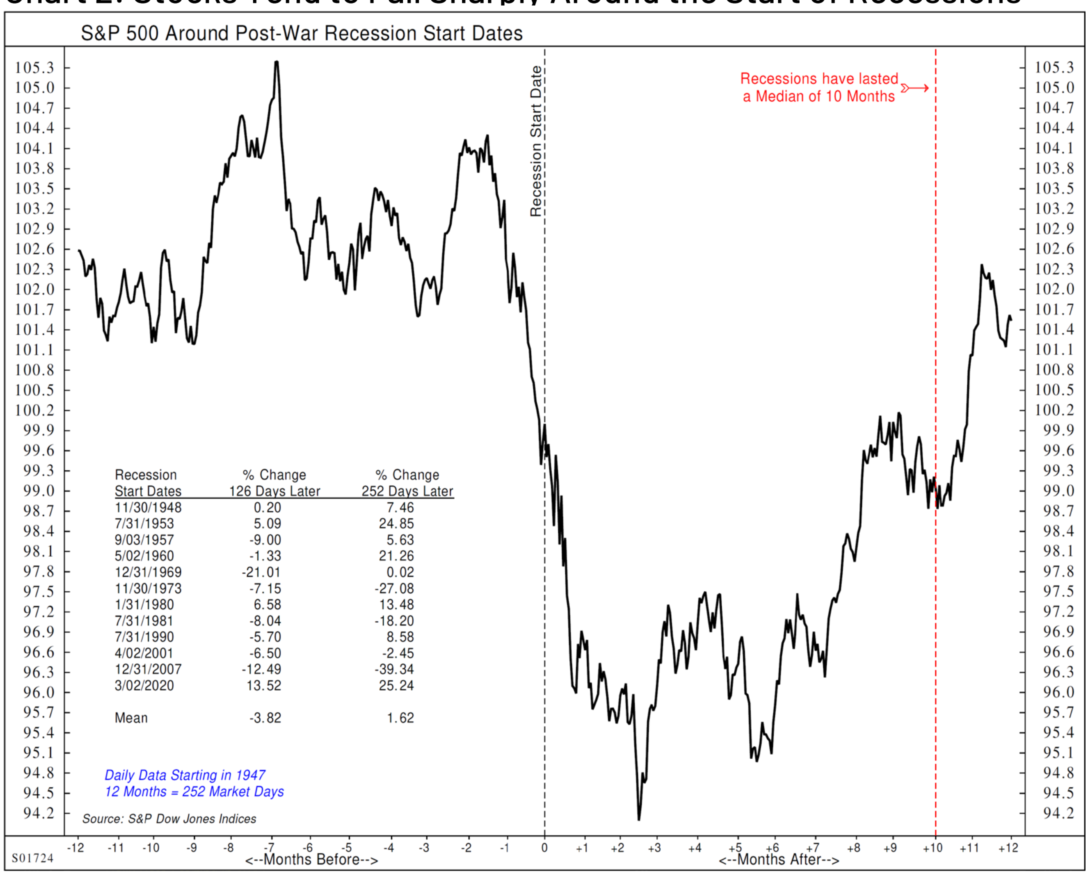
Economic Resiliency Matters for the Stock Market

It is unclear whether 2025's extreme volatility will usher in a cyclical 'bear' market in the US, narrowly defined as at least a -20% correction off recent highs. The S&P 500, which recorded a peak-to-trough decline of about -19% from mid-February to early April before rallying strongly, has thus far barely avoided being labeled as such. But this near miss brings into focus the importance of US economic health to stock market returns in volatile conditions.

An NDR Research historical study spanning 125 years using the Dow Jones Industrial Index suggests that **cyclical bear markets that are not subsequently followed by a recession (defined as two straight quarters of contraction in US GDP) are much shallower and shorter than 'recessionary bears.'** To this point, non-recessionary bear markets are down an average of -25% over an average span of 212 days, while bear market downturns associated with recession average a -35% drop and last 353 days on average. Regardless of a bear market label, similar research studies by NDR on the S&P 500 suggest stocks tend to decrease sharply at the onset of a recession (see Chart 2, below). To us, this underlines the importance of trying to identify impending recessions if possible…as 'forewarned is forearmed'.

These linkages between recessions and stock market returns pass the 'common sense' test, in our opinion. This is because economic downturns tend to damage the trend of corporate earnings, which we believe are a primary driver of stock prices over an intermediate (12-24 month +) period. Parsing the last twelve US recessions going back to 1947, S&P 500 earnings have fallen in nine out of the twelve, by a mean of over -16% (source: NDR Research, RiverFont). While 'stagflationary' recessions such as 1973 or 1980 tend to have relatively mild to nonexistent earnings downturns (as inflation can actually boost revenue in nominal terms), deep deflationary recessions, such as 2008, tend to witness much more dramatic earnings declines.

Chart 2: Stocks Tend to Fall Sharply Around the Start of Recessions



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CONCLUSION

The bottom line is that the instance and type of recession matters a lot for stocks, through the transmission mechanism of corporate earnings. **This is what makes our call for no recession and continued earnings resilience a key pillar of our generally constructive stance on US stocks… despite recent headline-related volatility.**

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All charts shown for illustrative purposes only. Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Ned Davis Research (NDR) is a global provider of independent investment research, solutions and tools. Founded in 1980, NDR helps clients around the world make objective investment decisions.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa). This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and *may continue to have, negative effects on the economies and securities markets of certain emerging market countries.*

Index Definitions:
Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

Definitions:

The European Union (EU) is an international organization comprising 27 European countries that governs common economic, social, and security policies. It serves as a political and economic alliance promoting democratic values among its member nations and is recognized as one of the world's most powerful trade blocs.

The Purchasing Managers' Index (PMI) is an indicator of the prevailing direction of economic trends in the manufacturing and service sectors.

Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.

A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth indicate a recession. However, more complex formulas are also used to determine recessions.

Gross Domestic Product (GDP) is the monetary value of all finished goods and services made within a country during a specific period. GDP provides an economic snapshot of a country, used to estimate the size of an economy and growth rate.

Stagflation is an economic cycle characterized by slow growth and a high unemployment rate accompanied by inflation. Economic policymakers find this combination particularly difficult to handle, as attempting to correct one of the factors can exacerbate another.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio. Asset class weighting discussion refers to our Advantage portfolios.

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