THE Wealth REPORT

HOW TO PULL OUT OF A DECLINE: LESSONS FROM THE LAST RECESSION

Overview

According to the National Bureau of Economic Research, the Great Recession that began at the end of 2007 was considered the worst in U.S. history since the 1930s. That is, until the coronavirus hit our shores.

Some academics claim that the 2008 recession would have been much worse had Congress, the U.S. Treasury and the Federal Reserve not conducted a series of proactive measures.[1] Because the recent economic decline is still ongoing — with containment of the virus nowhere in sight — it remains to be seen whether government actions will be enough.

It's been more than 10 years since the last major financial crisis in this country. Is that recent enough to remember the painful lessons learned, or will individuals, industry and the government have to learn those lessons all over again?

Stimulus Checks

In the immediate aftermath of the Great Recession, Congress passed several important pieces of legislation in an effort to alleviate financial strain and jumpstart the economy. The first was the 2008 Troubled Assets Relief Program (TARP), also known as a $700 billion bank bailout. In 2009, Congress followed up with the Economic Stimulus Act, which sent out $14.2 billion in the form of $250 stimulus checks sent to Social Security and Supplemental Security Income recipients, as well as veterans and railroad retirees. The idea was that the more than 52 million beneficiaries would immediately spend the money, which would help jump-start the economy.[2]

That was basically discretionary income for retirees, but it did little to help workers who lost their jobs, their health care and, for many, their homes because they could no longer pay the rent or mortgage. While the bailout in the financial sector helped stabilize banks so that depositors could withdraw money, it did not stop lending institutions from foreclosing on homeowners or penalizing borrowers who could no longer make their auto or credit card payments.

The American Recovery and Reinvestment Act allocated $247 billion for immediate relief to families (via stimulus checks of $600 per adult; $300 per child), as well as a mix of tax cuts, tax credits and extended unemployment benefits. However, when your goal is simply to pay the bills and make ends meet during an economic crisis, stimulus money does little to kick-start buying habits. One survey found that only 20% of people who received checks spent the money; the majority paid off debt or placed it in savings.[3]

Another $106 billion was earmarked to create jobs via modernizing federal infrastructure and increasing alternative energy production. Health care, education and science research programs received a combined $273 billion, while small businesses were allotted $54 billion in tax deductions, credits and loan guarantees.[4]

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Great Recession Numbers[5]

- 8.8 million jobs lost
- 10% unemployment rate
- 8 million foreclosed homes
- Average home price declined 40%
- $19.2 trillion lost in household wealth
- S&P 500 declined 38.5%
- $7.4 trillion lost in stock wealth (avg. $66,200 per household)
- Employer-sponsored savings/retirement account balances declined 27%

Quantitative Easing

The Federal Reserve stepped in with an aggressive monetary policy known as quantitative easing. This means it purchased about $2.1 trillion in Treasury bonds and mortgage-backed securities in an effort to flood money directly into the U.S. financial system.[6]

The Fed also mandated stringent reserves and investment guardrails on the nation's largest financial institutions in order to meet "stress test" guidelines.[7]

"Sounds a bit like the Great Depression and the New Deal. But while the Depression led to both a revolution in economic thinking and a host of huge institutional and legal changes (e.g., the FDIC, the SEC, Glass-Steagall), the Great Recession has not." [8]

2020 Pandemic-Induced Economic Decline

The initial numbers that launched the 2020 recession were actually worse than that of the Great Recession. The U.S. economy contracted by a record 31.7% in the second quarter. The unemployment rate surged to 14.7%. Retail sales plummeted by 16.4% and, in March, the Dow Jones Industrial Average (DJIA) set four new record drops, culminating in a one-month decline of 20.3%. This marked the end of the 11-year bull run.[9]

Over March and April, Congress passed four pieces of legislation for a combined total of more than $2.5 trillion in stimulus dollars.[10] In October, Fed Chairman Jerome Powell urged lawmakers to provide more stimulus in order to help the recovery move stronger and faster.[11]

However, perhaps it's worth taking a look back at how well the economy recovered in response to past interventions.

Target Consumers

During the Great Recession, lawmakers looked to bail out Wall Street first. The strategy was a holdover from the Reaganomics "trickle-down

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theory," wherein wealthy financiers would then be able to help the masses. Except during the recession, Wall Street recovered but Main Street did not. Companies looked internally to reduce labor costs and shore up fundamentals to continue delivering value to shareholders. However, this meant jobs did not return and, as a result, homeowners struggled to get above water on their mortgages.

During the recent pandemic, one round of stimulus focused on helping consumers, with a single check for $1,200 mailed out to the majority of adults. The second priority was to prop up small businesses hurting due to the shutdown — both through formal mandates and the ongoing loss of business from people reluctant to engage in the economy for fear of contracting the virus.

To add insult to injury, many small-business loans ended up at companies far better capitalized than Main Street mom-and-pop stores. The likes of P.F. Chang's China Bistro and TGI Fridays received Paycheck Protection Program (PPP) loans of between $5 million and $10 million. Meanwhile, many small-business owners who didn't meet minimum loan qualifications lost out.[12] Without money to keep workers on the payroll, many businesses have been forced to shut down permanently. And without income, many Americans are left with no way to pay bills or engage in spending to help grow the economy.

Moving forward, policymakers may want to consider a reverse policy, where capitalizing individual households not only helps them pay bills, stay in their homes and build wealth, but they also continue spending, which helps save jobs, contribute to tax rolls and stimulate economic growth.

Conditional Bailouts

The PPP did incorporate one lesson from the Great Recession: placing conditions on bailout money. In 2008, many government funds were used to pay out bonuses to C-suite executives rather than save jobs. This time around, PPP loans may be forgiven if the funds are used for eligible expenses — such as maintaining payroll.

Market Expectations

Oddly enough, one aspect of the economy that has held steady during both downturns has been the stock market. Despite initial and intermittent volatility, investors who stayed the course have been rewarded with a long-running bull market. Even now, although the bull market has officially ended, the markets continue to perform well in the wake of an uncontained virus and weak economic numbers. The main takeaway is that this is true only for well-capitalized investors who have retained employment and do not need to dip into investment assets to sustain day-to-day expenses.

Unfortunately, 45% of Americans are not invested in the stock market and do not benefit from market gains.[13] This continues to exacerbate the problems related to income disparity — particularly during an economic downturn. Again, fewer people who live on secure financial footing means fewer people spending, investing and growing the economy.

Personal Lessons

Rank-and-file investors with retirement plans should take comfort in the remarkable stock market performance of the past decade. It's important to maintain a robust, liquid savings account for emergency situations, so you don't have to withdraw from your portfolio during an unpredictable market downturn.

The key is to keep regular expenses low during both good times and bad. Fortunately, this was a hard-learned lesson from the Great Recession that has stuck with many Americans — both young and old. In fact, the personal savings rate has increased steadily since the last recession, now boasting an average of 4% for the first time since the late 1990s.[14]

Individual investors also have done a good job of constructing investment portfolios built to weather economic declines. This means not only diversifying across a traditional mix of stocks, bonds and other securities but also incorporating guaranteed income products such as annuities. While annuities are complex vehicles with additional rules, restrictions including limited liquidity, and in some instances fees, they do offer a stream of guaranteed income payments, and some offer contract owners the opportunity to earn interest credits based in part on the participation of an index, while not actually investing in or participating in the index. Additionally, annuities protect against loss of principal due to market fluctuations.

Final Thoughts

Although financial crises tend to be cyclical and unavoidable, it seems to be human nature to forget the lessons we learn and repeat the same mistakes. This holds true for both policymakers and personal households. It's a good idea to keep your focus on the outcome you want to achieve. Set financial goals, build a savings and investment plan designed to keep you on track, then spend the rest of your time enjoying your life and career.

Also, don't go it alone. Financial professionals have studied and experienced these lessons along with their clients, so they've seen more financial scenarios than a single household can imagine. An experienced financial advisor can offer guidance and recommendations aimed at helping you through periodic economic declines, stock market volatility and even temporary losses of household income. After all, it's the lessons we learn that can help prevent us from making the same mistakes twice, so look to your advisor to help you through uncertain times.

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