



## Second Quarter 2023 Client Newsletter

# Recessions Are Hard To Call, But We Know What Comes After

In the movie *Being There*, Peter Sellers plays a simple-minded gardener called Chauncey who is accidentally swept up into a circle of high influence in Washington, D.C. Everyone he meets mistakes his blank expression for an intent interest in what they have to say. And his simple statements about the basics of gardening are taken as deep wisdom.

When the President asks Chauncey his advice about the economy, Seller's character answers, "In the garden growth has its seasons. First comes spring and summer, but then we have fall and winter. And then we get spring and summer again."

The President replies, "That is one of the most refreshing and optimistic statements I've heard in a very long time."<sup>1</sup>

It's an amusing scene, yet like all great comedy is at least 95% true. When we look back at the market's performance in the second quarter and wonder about what might lie ahead, Chauncey's line about the seasons following one another makes quite a bit of sense.

After 2022's economic winter, investors have spent the first half of 2023 looking for any signs of spring. High inflation, repeated interest rate hikes, labor shortages, and other factors have created an environment that's been hostile to growth. Yet late in the quarter we are beginning to see signs that these economic headwinds are beginning to die down.

The financial pundits have been filling their allotted airtime with daily speculation about which way the economy is headed. Some have been cautiously optimistic. Some have been pessimistic. But as usual, the doomsayers have a much more riveting story and often a book to sell and so more often get the headlines.

As much as we all want to know right now how the economy is doing and which way it is headed, official assessments by real economists take time. A trove of diverse data must be analyzed and often the bellwethers we took for a fact a few months ago turn out to have been misleading.

Because of this lag time, we can never know if we are in a recession today. Take for example the

economic downturn of 15 years ago. The official announcement that the economy was indeed in a recession came in December 2008—a year after the recession had actually started. By then stock prices had dropped more than 40%. And although that recession ended in May 2009, the announcement came 16 months later, by which time U.S. stocks had rebounded.<sup>2</sup>

However, even though we might not know the direction the economy is headed at any given moment, we do know that just as spring follows winter recoveries follow recessions.

Dimensional recently did a study of post-recession returns for the 75 year period beginning in 1947, the first year that U.S. gross domestic product data was calculated on a quarterly basis. (Note: there have been 12 official recessions during this period.) The analysts looked specifically at the 1-, 3-, and 5-year returns of the S&P 500 after the recession start dates.

They found that over this period the average 1-year return immediately following a recession was 6.4%. The 3-year average was 43.7%. And the 5-year was 70.5%.

As you might expect, the 1-year return is about half the average for all months of that period. But surprisingly, the 3-year return is 1% higher than the average. This is because after a downturn the market tends to enter a period of growth.

Chauncey from *Being There* was more right than he knew. The market is in many ways like a garden. Its growth is the result of innumerable complex processes, some of which are not fully understood.

Consider the massive amounts of information stored in a single bean seed. Once placed in dirt, it senses when to sprout. It knows how to collect water and nutrients from the soil. It directs its growth directly against the force of gravity, while angling its leaves for maximum sunlight. It lures in bees to pollinate its blossoms. And then it makes hundreds of copies of itself.

The good news is that you don't need a PhD in botany to grow a bean plant. You just poke a seed into some

moist topsoil. A four year old can do it. And that's similar to investing in the market. You don't need to understand its mind-numbing complexities for it to work for you.

Of course a master gardener can help you maximize your bean yield. Or if you're impatient, warn you against digging up your seeds to see if they are sprouting. A trusted advisor can help you in similar ways with your investments.

Also like a garden, the market will have seasons where things aren't going to grow very well or maybe not at all. But these have always passed. And the prudent investor realizes that because he or she cannot predict when the market will enter a period of recovery, the only chance of benefiting from those unexpected big days is to have their money in the market.

In other words, you can miss out on the growing season when you don't have your seeds in the ground.

#### Sources:

1. <https://www.imdb.com/title/tt0078841/characters/nm0000634>

2. <http://elink.dimensional.com/m/1/62855187/02-b23156-ab54fdf6dcce49108472a6224b1dd78e/1/75/9b9c6736-3673-4677-b6df-b0f554dc1ed9>



# Index Returns\*

<b>U.S. Stocks</b>	<b>Quarter Return 4/1/2023 - 6/30/2023</b>	<b>1 Year Ending 6/30/2023</b>	<b>3 Years Ending 6/30/2023</b>
US Large (S&P 500 Index)	8.74%	19.59%	14.60%
US Large Value (Russell 1000 Value Index)	4.07%	11.54%	14.30%
US Small Cap (Russell 2000 Index)	5.21%	12.31%	10.82%
US Small Cap Value (Russell 2000 Value Index)	3.18%	6.01%	15.43%
US Micro Cap Index (Russell Micro Cap Index)	5.29%	6.63%	9.09%
CRSP US Total Market Index	8.41%	18.94%	13.77%
CRSP US Large Cap Value Index	3.57%	10.86%	15.42%
CRSP US Small Cap Index	5.29%	14.78%	12.49%
CRSP US Small Cap Value Index	4.62%	12.96%	18.07%
<b>International Stocks</b>			
International Large (MSCI World ex USA Index)	3.03%	17.41%	9.30%
International Large Value (MSCI World ex USA Value Index)	3.12%	15.49%	12.07%
International Small Cap (MSCI World ex USA Small Cap Index)	0.49%	10.05%	6.42%
Emerging Mkts (MSCI Emerging Markets Index)	0.90%	1.75%	2.32%
Emerging Mkts Small Cap (MSCI Emerg Mkt Sm Cap Index)	6.39%	13.28%	13.72%
<b>Bonds</b>			
Short Term Bond (ICE BofAML US Treasury Index 1-3 Years)	-0.34%	0.52%	-0.87%
Aggregate Bond (Bloomberg Barclays U.S. Aggregate Bond Index)	-0.84%	-0.94%	-3.96%

**\*Disclosures:**

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# Appendix

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## U.S. Stocks

**US Large (S&P 500 Index)** – This index measures the performance of 500 widely held stocks in the US equity market. Standard and Poor's chooses member companies for the index based on market size, liquidity and industry group representation.

**US Large Value (Russell 1000 Value Index)** – This index measures the performance of the large-cap value segment of the US equity securities. It includes the Russell 1000 index companies with lower price-to-book ratios and lower expected growth values.

**US Small Cap (Russell 2000 Index)** – This index measures the performance of the 2,000 smaller companies included in the Russell 3000 Index.

**US Small Cap Value (Russell 2000 Value Index)** – This index measures the performance of the smallcap value segment of the US equity universe. It includes those Russell 2000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 year) growth and lower sales per share historical growth (5 years).

**US Micro Cap Index (Russell Micro Cap Index)** – This index measures the performance of the microcap segment of the US equity market and consists of the smallest 1,000 securities in the small-cap Russell 2000 Index, plus the next 1,000 smallest eligible securities by market cap.

**CRSP US Total Market Index** – This index measures nearly 4,000 constituents across mega, large, small and micro capitalizations, representing nearly 100% of the U.S. investable equity market.

**CRSP US Large Cap Value Index** – This index measures securities assigned to a size-based market cap index using CRSP's multifactor model. CRSP classifies value securities using the following factors: book to price, forward earnings to price, historical earnings to price, dividend-to-price ratio and sales-to-price ratio.

**CRSP US Small Cap Index** – This index measures U.S. companies that fall between the bottom 2-15 percent of the investable market capitalization. There is no lower limit in market capitalization, other than what is specified by investability screens. The index includes securities traded on NYSE, NYSE American, NYSE ARCA, NASDAQ, Bats Global Markets and the Investors Exchange.

**CRSP US Small Cap Value Index** – This index measures securities assigned to a size-based market cap index using CRSP's multifactor model. CRSP classifies value securities using the following factors: book to price, forward earnings to price, historical earnings to price, dividend-to-price ratio and sales-to-price ratio.

## International Stocks

**International Large (MSCI World ex USA Index)** – The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries\*-- excluding the United States. With 887 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

**International Large Value (MSCI World ex USA Value Index)** – The MSCI World ex USA Value Index captures large and mid cap securities exhibiting overall value style characteristics across 22 of 23 Developed Markets countries\*. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.



**International Small Cap (MSCI World ex USA Small Cap Index)** – The MSCI World ex USA Small Cap Index captures small cap representation across 22 of 23 Developed Markets (DM) countries\* (excluding the United States). With 2,563 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country.

**Emerging Markets (MSCI Emerging Markets Index)** – The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries\*. With 1,387 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

**Emerging Markets Small Cap (MSCI Emerging Mkt Sm Cap Index)** – The MSCI Emerging Markets Small Cap Index includes small cap representation across 24 Emerging Markets countries\*. With 1,823 constituents, the index covers approximately 14% of the free float-adjusted market capitalization in each country. The small cap segment tends to capture more local economic and sector characteristics relative to larger Emerging Markets capitalization segments.

## Bonds

**Short Term Bond (ICE BofA US Treasury Index 1-3 Years)** – The ICE U.S. Treasury 1-3 Year Bond Index is part of a series of indices intended to assess the U.S. Treasury market. The Index is market value weighted and is designed to measure the performance of U.S. dollar-denominated, fixed rate securities with minimum term to maturity greater than one year and less than or equal to three years.

**Aggregate Bond (Bloomberg Barclays U.S. Aggregate Bond Index)** – The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market. This includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities and collateralized mortgage-backed securities.