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Recessions Are Rare, Worries About Them Aren't

Investors are always worried, sometimes about things that should make them happy.

For example, we fret about how many years the economy has gone without stumbling. It just seems natural that an expansion that has lasted very long must be living on borrowed time.

The good news is that economic cycles aren't like people—they don't die of old age.

And when expansions do end, the consequences aren't nearly as awful as they used to be, at least for Americans.

Whereas your savings could have been wiped out on several occasions when the country was young—there were the Panics of 1785, 1789, 1792, 1796, 1819, 1825, 1837, 1847, 1857, 1873, 1884, 1893, 1896 and 1907—crashes, bank runs and even recessions are rare now.

Americans are enjoying what would have been a record-long expansion before World War II. The previous one, ended by Covid-19, was the longest ever. Jim Reid, who heads macroeconomic research at Deutsche Bank, points out that five of the top seven were in the past 43 years.

That isn't a coincidence. Governments and central banks have been willing and able to boost a sagging economy since inflation has been tamed and globalization took off. And all those panics were before the Federal Reserve or deposit insurance existed. Back then, governments didn't even engage in automatic countercyclical spending like unemployment insurance.

Reid wonders if stimulus might flow as freely the next time the economy needs it, though. Federal borrowing has mushroomed and shows no sign of slowing with tax cuts just signed into law. That has spooked the Treasury market on a few occasions recently.

Even if plenty of cash is forthcoming from Washington the next time the economy swoons, what if it results in higher bond yields? They normally fall when a recession hits, cushioning retirement portfolios and lowering the costs of mortgages and corporate loans.

The Fed might not come to the rescue as readily either, Reid says. If inflation is higher because of protectionism and demographic challenges, central banks could be cautious about cutting rates.

And then there's a danger that really might be an indirect result of such a long period of smooth sailing. While expansions don't die of old age, former Fed Chair Ben Bernanke once joked they can "get murdered."

Overconfidence makes policy mistakes like keeping interest rates too high or entering into a trade war more likely.

And, as we saw with the tech and housing busts, confidence also encourages excesses to build up as investors project growth to infinity. Valuations get silly and credit too loose, making downturns more painful.

With stocks so expensive and credit spreads so tight, maybe it's healthy for investors to be a bit worried.

—Spencer Jakab