It's Time to Talk About a Potential Recession in 2025

Dear O'Brien Client-

There have been growing policy headwinds for the U.S. and global economies in 2025, headlined by the Liberation Day tariff announcements a few weeks ago. While reciprocal tariffs have been temporarily suspended for most countries, the tariff rate currently in place (i.e. despite the temporary reduction in tariffs on smartphones and computers) on China is high enough to more than offset the benefits of suspensions elsewhere.

As things currently stand, tariffs in place equate to a roughly $1 trillion tax on U.S. businesses and consumers.[1] This is roughly three percent of the U.S. economy and represents the largest tax hike since World War II. Tariff rates north of 100% on bi-lateral trade between the U.S. and China essentially shutdown the trade in goods between the two largest economies.

It is unlikely that U.S. businesses can find immediate alternatives to the roughly $450 billion in goods they import from China – which raises the risk of another supply chain shock similar to coming out of COVID. Unlike the post-COVID period though, U.S. households are not flush with excess cash from stimulus checks. Roughly 60% of U.S. households are living paycheck to paycheck and it is unlikely they will be able to absorb the cost of this looming tax hike.

These developments are meaningful threats to economic growth for the U.S. and global economies for this year.

Recessions are unpleasant, but are also key parts of economic cycles, in that they rapidly clear out imbalances and position economies for their next expansion. The fewer the imbalances at the end of the recession, the longer the subsequent expansion is likely to last. The longer the expansion lasts, the greater the stock market return opportunity for investors.

We wanted to re-share our bear market (declines of at least -20%) framework given the rise in recession risks to help provide a guide for what additional downside might look like if a recession arrives.

Since the 1830s, the U.S. has experienced roughly 30 bear markets. Broadly speaking, these fall into three different categories:

1) Structural: triggered by structural imbalances and financial bubbles (e.g. the Global Financial Crisis)
2) Cyclical: typically caused by economic contractions
3) Event-Driven: triggered by one-off "shocks" that do not result in recession (e.g. oil price shocks)

To be clear, the S&P 500 still has not quite entered a bear market. If it were to do so, history suggests the average peak-to-trough decline would be around 30% (the S&P 500 is down roughly 15% currently). The average length of cyclical bear markets has been two years, although in the post-World War II (post-

[1] Source: JPMorgan, as of 4/10/25.

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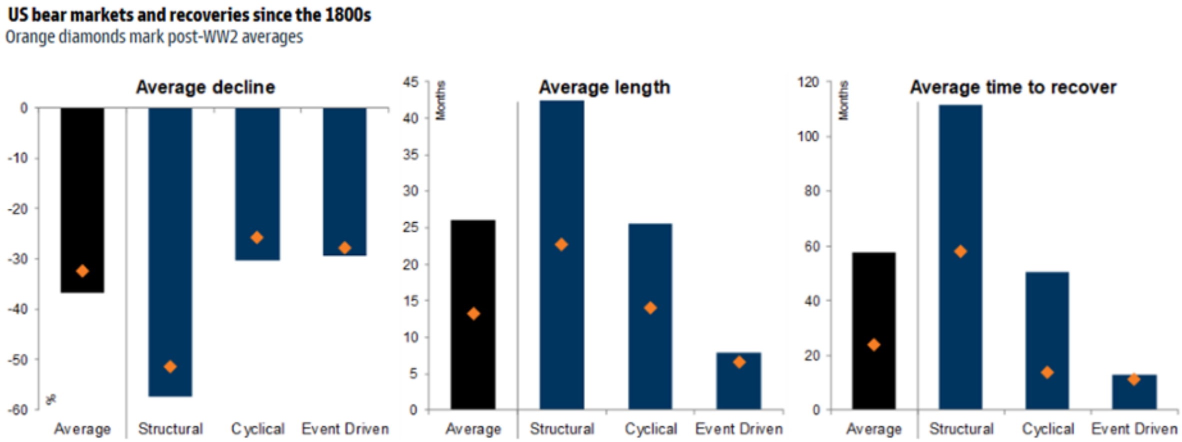
WW2) period they have been closer to a year – see the orange diamond in the charts below. The average time to recover losses in the post-WW2 era has similarly been roughly a year.



Source: Goldman Sachs Global Investment Research

It is also worth noting we do not see the types of imbalances and/or market dislocations in today's economy and financial system that have correlated with structural recessions. If a recession were to happen, it would likely be policy-driven and not driven by the sort of dynamics that caused the Global Financial Crisis.

All of this brings us to the crux of the question on many investors' minds today: if recession probabilities are rising – and we know there is likely more downside if one arrives – why not reduce risk further?

First, time in the market matters more than timing the market. Markets tend to rise more often than they decline. We are long-term investors because it allows us to capitalize on that dynamic. Recessions, while painful, also tend to be short-lived. They are also usually preceded by big stock market run-ups, which can make the subsequent declines a little less painful as they are from higher starting points.

Second, in six of the past seven recessions, stocks started to rally while layoffs were still occurring and the economy was contracting. We don't know when the next market bottom will occur, but being invested during that initial rally meaningfully reduces the time until losses are recovered.

Third, recession risks today are largely policy driven, and those policies can change at the discretion of policymakers. If the next few changes move policy in a more positive direction (e.g. reduced tariffs, reduced regulation, tax cuts), then the risk of recession could be reduced just as rapidly as it has risen.

Fourth, both monetary and fiscal policymakers have room to stimulate growth, if necessary, which could truncate a recession. The Federal Reserve can meaningfully cut interest rates and/or re-introduce quantitative easing. Similarly, President Trump could always announce a "DOGE savings" stimulus check if the economy contracts again.

Finally, American consumers are known as the spenders-of-last-resort for the global economy. As long as they have jobs they will likely continue to spend, which could help the economy muddle through tariff headwinds without a recession occurring.

While we can't prevent paper losses if a recession occurs, we have been preparing for a potential downturn for the past two years and have taken action to try to reduce the magnitude of any declines that do occur. When the current expansion started to show signs of maturation, we began to reduce allocations to riskier markets such as small cap stocks and high yield bonds in favor of assets that historically hold up better in downturns, such as blue-chip stocks and treasuries. High quality bonds have, in fact, risen in value during the S&P 500's decline[2]. We are also taking advantage of tax loss harvesting opportunities as they present themselves – a silver lining of market downturns.

We also aim to not only keep you invested through this volatility but also maintain your asset allocation targets while reducing risk within each asset category.

Finally, we will be prepared for the opportunity to add back to riskier markets when the economy slips into recession – there will always be another recession, the question is when. Stock markets usually begin to recover before the economy – which can present long-term investors that ride out the short-term volatility with great buying opportunities. Over the past three decades, roughly 80% of the stock market's best days have come during either bear markets or within the first two months of a new bull market[3].

If you have any questions or would like to talk about your specific situation, please do not hesitate to contact your Advisor.

Your O'Brien Team

[2] The U.S. Aggregate Bond Index – which is comprised of investment-grade rated debt securities – has risen 1% since the S&P 500 peaked on February 19th.

[3] Source: Ned Davis Research, Morningstar, Hartford Funds, as of 12/31/23.

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