TRANSCRIPT

The anatomy of a recession

Jeff Schulze: Good morning or good afternoon to everybody. Thank you everybody for joining here. Again, my name's Jeff Schulze. I'm the Investment Strategist with ClearBridge, and what that really means is I'm responsible for coming up with the firm's macro and market outlook, not only here for the U.S. but for the international space as well. And the program that you're going to see here today talks about where we are in the economic cycle, and more importantly, what that means for market activity moving forward.

And the focal point of this presentation really over the last four or five years has really been on slide 2, our recession risk dashboard, a group of 12 variables that have done an excellent job of foreshadowing an upcoming recession. And on the left-hand side of the page, you can see that they run across the four fault lines of the economy. So, at the very top, you can see that we look at financial stresses. Usually you'll see financial stresses emanate first before the economy actually rolls over. Below that, we look at inflation. The Fed looks at inflation, so that's something that we want to be cognizant of as well. Below that we look at consumer health. That's the biggest part of this dashboard because it's the biggest part of the US economy. And then last but not least at the bottom, we look at business activity because businesses are responsible for hiring and doing capex, both of which have a multiplier effect on Main Street. And it's a stoplight analogy, meaning green is good, yellow is caution, and red is recession, and if you look all the way to the right-hand side at the bottom, you can see that coming in to January, we had a yellow cautionary signal. We felt that the US economy was vulnerable to a recession, and a catalyst could have pushed us into a recession, and we've been advocating to our clients to upgrade in quality, know what's your own, focus on companies that have most around their businesses, maybe a sustainable or growing dividend stream. And we didn't know what that catalyst was going to be, and obviously, we never thought it was going to be a global pandemic, but that obviously was the catalyst this time around, and we're clearly in a recession at the given moment.

But on March 15th, we did a mid-month update to the Anatomy of a Recession community, which encompasses about 22,000 subscribers, and we had said we felt a recession was on the horizon, but we needed the economic data to catch up with the dashboard, and soon enough, by the time we got to the end of March, we had three indicator changes: ISM New Orders, which is part of manufacturing PMI went from yellow to red, commodities went from green to red, and then last but not least, jobless claims went from green to a very, very red signal overall, bringing the recession risk dashboard to a red recessionary signal.

Now on the next page, you can see how this dashboard has done throughout time, and you can see this is the output of the dashboard the month that we headed into a recession, and we nailed six out of seven of these recessions. The only one that we were a little bit late to the game was the time frame in 1973-1975, and this is a similar dynamic to where we find ourselves today, and out of all seven of these, this is probably the one that has the strongest parallels. First off, it started off as a supply shock. In 1973, you had the start of the oil embargo where oil prices went up over 400% from the bottom until the eventual peak. But that supply shock morphed into a demand shock where consumer spending, it was much higher in the US on oil back then. People were paying more at the pump. They retrenched their spending altogether, and it caused a pretty nasty recession that lasted the better part of 15 months. You think about that framework to today. This started off as a supply shock in China when China's economy went offline to fight COVID-19, but it morphed into a demand shock when the virus came back to the US, and you saw a broad swath of the economy shut down. And similar to 1973, the dashboard was yellow in the first month of that recession, but it turned red the very next month as the economic data caught up.

But, the key takeaway here is that the economy was in a vulnerable position before we headed into this recession, and this is going to make this recession much deeper, and you're going to have lingering effects much longer than whether this happened four years ago when the US economy was on a much more solid foundation.

And the reason why I say that is the next slide, is profit margin. This is one of the indicators that we have in the recession dashboard, and it was flashing red as we moved into the COVID-19 crisis. Now we don't look at S&P 500 profit margins because those typically are the best companies in the world. They have a lot of levers that they can pull in order to maintain their margins, and quite frankly, S&P 500 margins deteriorate as you're heading into a recession. What we like to look at is a much larger viewpoint of the US economy which is called NIPA profit margins. This looks at micro, small, mid, large and mega-cap companies, and it's a much better barometer of what's going on in the country as a whole.

Now if you look at the chart on the top-right-hand side, that red dotted line is where we thought NIPA profit margins were coming into the middle part of 2019. But in July of last year, you saw a huge revision down of NIPA profit margins of $200 billion. That's a large revision outside of a recession. And right below that red dotted line, that blue line is where profit margins for the US economy has been, and you could see that it's been flat since roughly 2015. Now this is really important, because this has disproportionately affected micro and small-cap businesses because of a strong labor market and higher compensation costs, but also the inability of these companies to pass tariffs through to their consumers. And if you look at the pie chart on the left-hand side, you can see that 59% of Americans work for a company that has less than 1,000 employees. Your average Russell 2000 company which a lot of people on this call probably think of a small-cap, employs closer to 3,700 people, which is roughly four times the size where most Americans work. So, you had broad profit margin stresses for most companies in the US before we entered into this downturn.

And this was clearly evident on slide five, where job openings have been declining dramatically since the beginning part of 2019. Now job openings is one of the best indicators out there for the labor market. The key reason why we don't have it in the recession dashboard is because it only has a history going back to 2002, so it doesn't have a 50- or 60-year history that we tend to look for. But it is one of the items that we have on our secondary dashboard that we've used internally. And job openings, they've been moving down, and it wasn't because you weren't able to find qualified labor, which has been one of the biggest problems for small businesses. It's because they decided that the cost of incentivizing the right employee was not worth it in light of the margin pressure that they were facing. And if you think about the most recent job print that we got, you saw massive layoffs in the areas that you thought you were going to see layoffs in. You saw massive layoffs in leisure, hospitality, retail, for example, but you did see layoffs across the spectrum, and I think this is really important because a lot of companies are letting go of employees, even if they continue to remain operational, but their revenues declined just a little bit because of the margin pressure that we've seen. And this is important, because when the economy starts to open up, there's going to be a lot of individuals that go to transition back into their work, but there's still going to be a lot of individuals that are going to be on unemployment because there's not going to be a full-time job waiting for them, and this was very obvious from a paper that recently came out by the NBER. If you're not familiar with that organization, it's the institute that's responsible for telling whether or not the US goes into a recession or not. And they published a paper from a group of Harvard professors and University of Chicago professors, and they went out and surveyed 5800 small businesses. And the most important takeaway from that survey was that out of the businesses that were still operational; i.e. they weren't shut down because of COVID-19, they had shed 17.5% of their full-time employees, and they shed 36% of their part-time employees. So again, because the US economy was vulnerable, I think you're going to see the layoff situation exacerbated, which is clearly seen with the jobless claims numbers over the last seven weeks. But I think when we get to the other side of this storm, you're going to have an unemployment situation that's going to remain elevated, and it wouldn't be a surprise to us at ClearBridge if you see an unemployment rate in the 9, 10, or 11% range as we transition into next year, which again is going to be a half-year after the economy starts to reopen.

Now on slide 6, this is another reason why we've been advocating caution, upgrade in quality in your equities. Don't sell your equities because everybody has a long-term perspective, but just upgrade in quality, focus on dividend growers, dividend payers, high-quality balance sheets, is because if you look at the last number of times that the Fed has cut, and we look at the last four times that the Fed has cut three times, two of them ended up being soft landings, two of them ended up being recessions. Now the key point here is that in the two soft landings and the two recessions, three months after that third rate cut, generally speaking, the markets are going to cheer the Fed. The markets are going to think that the Fed has saved the day. But it's only six months after that third rate cut where you truly know whether or not you're in a recession or a soft landing type of scenario. The two soft landings, you saw positive market performance, six months after that third rate cut. In the two recessions, you saw negative market performance, and again, in January when we were talking about advocating caution, upgrading in quality, a lot of people were seeing the market price action, they were very excited, but obviously, now that we've had this recession, this wound up being a negative print in a recession at the end of the day. But again, we've been advocating, you know, to know what you own, upgrade in quality throughout this entire process.

Now, let's talk a little bit about market structure on the next slide, and there's an old adage out there that the market takes the stairs up and the elevator down. This really means that it takes a long time for the market to climb to a peak, but it takes a shortened period of time for the market to roll over to eventually hit that next trough. Now if you look at all 15%-plus drawdowns that we've seen since the 1950s, the median time that it took to climb to that peak was 16 months, or close to a year-and-a-half. But after you hit that peak, it only took the market six months to sell off, but more importantly, once you've had that selloff complete, the markets take the elevator back up, and it only takes seven months to hit that previous peak yet again. So, we've certainly seen that here today with the robust rally that we've seen off the market lows.

But the next slide shows you that this selloff has been distinctly unique from what we've seen on history. This has been the fastest bear market from peak in the history of the US. It only took us 22 days to reach bear market territory, which again, is a decline of the S&P 500 of 20% or more. This is twice as fast as what we saw back in September of '29 as the markets went into the Great Depression. Now there's a key reason why this happened. First off, we think about the market coming into February, the markets are pretty fully valued. Right, the forward P of the market was at 18; the markets had anticipated a reacceleration of earnings growth back up to 10%. But when it became clear that the virus was going to reach US shores, and we're going to have broad shutdowns of the economy, a swift re-rating of equity markets was needed. So that was the first leg of the drawdown.

But importantly, because that was such a swift drawdown in the beginning because it was such a wide divergence of what was being priced in, that created a much more damaging liquidity crisis, as a lot of systematic investors out there were crippled by the combination of rising correlations and a large degree of leverage. And when you have that leverage, it created forced selling to stay within margin requirements, and when you have that, it creates a negative feedback loop, and it's a key reason why if you look in March,

March was the most volatile month in US history. The average move of the S&P 500 per day in March was close to 5%. But a key thing that happened is that the Fed recognized that this was on the very of becoming disorderly; they stepped into the markets in a very big way, as did Congress, and it's the key reason why we put a technical bottom at least for now in the markets, and the markets have continued to move higher.

But on slide nine, you know, if you continue to think that there's going to be choppiness in the market, we could see a market drawdown that we're not out of the woods quite yet. This look at the style box, and what areas may provide the best defense for your asset allocation. Now, conventional wisdom tells you that value is the place that you want to hide when the markets get choppy, but there's been a paradigm shift that happened back in 2005 as the markets and the global economy really moved into secular stagnation. And because of that, the most defensive areas of the style box, believe it or not, are now large-cap core and large-cap growth. So, what we did here is we looked at every selloff of 5% of greater that we've seen since 2005, so the last 15 years. There's been 24 of these selloffs. Large-cap core and Large-cap growth had the best average performance. So again, they protected the most on the downside. But more importantly, they have the highest hit rate. And what we mean by "hit rate" is how many times out of those 24 selloffs did that piece of the style box outperform? You can see that large cap core had a hit rate of 83%, so they had outperformed the market 83% of the time during those selloffs, and large-cap growth outperformed 75% of the time. If you look at the entire matrix here, the next closest hit rate to those two is small cap growth all the way down at 42%. And if you think about where we are today and the most recent selloff that we've seen, peak-to-trough, was about 35%. The two areas of the style box that outperformed is large-cap core, and large-cap growth. So, if we're going to continue to be in this secular stagnation, this low-growth environment, the "new normal" as a lot of people have put it, these are the areas of the style box that can give you a much better risk-adjusted return.

Now moving on to the next slide, we decided to look at the equity markets to maybe take a little bit more of a granular look. What areas, or what sectors of the equity markets, tend to outperform when you have major market drawdowns? And we define that as a decline of 15% or more in equity markets. On the left-hand side, that's the relative performance of each sector versus the market. So, consumer staples did the best. On average, during those seven drawdowns, consumer staples outperformed the S&P 500 by 20%, followed by utilities at 14%, and health care at 12%, so those are the three areas that provide you the most protection. If you look on the right-hand side, the hit rate, similar to what we just saw on the previous slide, how many times out of those seven times did you outperform, staples, utilities, and health care again were all with 100% a piece, and we look back to the most recent selloff we had, these three are still 100% hit rate; they outperformed yet again. Again, so if you think that there's going to be volatility, there's going to be some choppiness, these are the areas that, obviously the sectors that you want to have an overweight to, but also from a style box perspective, large cap core, and large cap growth give you that defensive characteristic that you're looking for to help give you a much better risk-adjusted return.

Now on slide 11, this looks at how long a recession typically lasts, and this is the last 18 recessions going back over a hundred years, and the average length of a recession has been a little bit over one year; it's been 13 months long. 2007-2009 was a much longer recession; it was actually a year-and-a-half. But I do have one recession highlighted in particular here, all the way to the left-hand side of the chart. We highlighted the 1918 recession, and the reason why we highlighted it, not because it was short, because that was the last time that we had a global pandemic. The Spanish flu happened during 1918. In fact, there was actually three waves of the Spanish flu. But the key takeaway here is the recession was relatively short as far as prime is concerned. Now there's a lot of pundits that think that this recession is going to be short, but I have my reservations; I think this is going to be a longer recession; it's probably going to be something that's going to be with us probably three or four quarters, and I think it's probably going to be near the average length of a recession when all is said and done. Nonetheless, Q2's GDP number is going to be extremely negative, so Q3 is going to be positive no matter how you look at it, just because we're coming off such a low base, but if you look at GDP on a year-over-year basis, I think we're going to be seeing negative print for at least three or four quarters.

But on slide 12, obviously stocks anticipate recoveries, right? Stocks generally sniff out a recovery before it's happened, and they usually sniff out the end of an economic cycle before it's happened as well. Before the end of an economic cycle, stocks usually peak about six months before the start of a recession, and before the beginning of a durable recovery, markets will start to price in that low three months before the recession formally ends. But if you look to the right-hand side, we looked at every recession since 1948, and the average peak-to-trough of the S&P 500 has been, decline has been 30%. This time around, we've lost 34%. So, we've certainly overshot what you've typically seen.

Now, there's a question that everybody's been asking themselves, and we actually talk about this quite a lot at ClearBridge, is has the lows for the markets been formed? And on slide 13, I would say there's a very strong possibility that the market lows have been formed, but history would suggest that there should be a little bit more caution. Now, if you look back since 1835, there's been 27 bear markets in the US. The fastest peak-to-trough in any of those instances was three months. The median time to get to a peak-to-trough was 17 months. Now admittedly, you're comparing recessions from the 1800s to now, it's comparing apples and oranges, but the fact that this peak-to-trough took 23 trading days is extremely fast. So, what I'm trying to say, is that V-shaped bottoms aren't necessarily the odds-on favorite. When you think about the bottoming process, it usually requires a retesting of the lows two, sometimes three times before something durable can take hold. And as a consequence of this, there's a lot of false starts along the way, better known as "counter trend rallies." Now, to illustrate this point, if you look on the left-hand side of the chart, it shows the largest counter trend rallies during the last seven recessions, and they've consistently gotten bigger over the years, especially during the last two recessions. Now, although we only show a 19% drawdown for the '01 recession, the market continued to decline after the recession ended due to the excesses of the dotcom bubble that had to be worked off. So, if you include the entire market drawdown period, there were three notable counter trend rallies during '01 and '02. The first one was 19%, which we obviously have listed here. We also had a 22% and a 21% counter trend rally, both of which would officially have been in bull market territory. And the great financial crisis, if you look on the right-hand side, there were eight notable counter trend rallies ranging from 7 to 24%. But you know, there's two counter trend rallies that I really want to highlight here, which is the third one over; it shows you that there was a counter trend rally in '08 that lasted for 51 days, so almost two months, so they could be quite long as far as time is concerned, but also the last one, all the way at the right-hand side. You can see that they can be quite bit as far as a peak-to-trough counter trend rally. That 24% gain happened after TARP's passage, but it fully unwound in January and February due to weaker-than-expected economic activity. There's a couple other counter trend rallies that aren't listed here. You saw a 19% counter trend rally after Black Monday's drawdown in 1987. And then also you saw a massive counter trend rally after 1929 into 1930, that one was 47%. Now, of course the policy response that we saw back in the Great Depression was the exact opposite of what we have today, but the key point here is that large counter trend rallies are a little bit more prevalent than you think.

And although I think there's a very strong possibility that the low has formed, history has suggested that caution is warranted, and because of the prevalence of these counter trend rallies, we decided to come out with our own proprietary recovery dashboard, which focuses on the conditions needed for a durable market and economic bottom, and that's on the next slide here. Now this is a dashboard of nine indicators, again that has done a great job of foreshadowing a durable economic and market bottom. There are some overlap here from the recession dashboard, but a lot of these are new indicators. But the goal here is to go from a recessionary red, move your way up to yellow improvement, and finally over to a green expansionary color.

Now this is really important because if you look at the next slide, this is the proof statement of the dashboard. Why you want this as your compass to tell you what is true north, this is the dashboard's output. When it went green in the last seven recoveries, and at the very, very bottom of the slide there you can see how long that green signal was from the end of the recession. So, after the 2007 and 2009 period, we were positive-five, which means we went green five months before the end of the recession. So, we went green at the end of January 2009; the end of the recession happened at the end of June of '09. So, we were five months early. The exact opposite dynamic happened in '01. We were a little bit late to the game. We went green one month after the recession ended. But if you look at all of these in totality, the signal has turned yellow on average five months before the end of the recession and turned green one month before the end of the recession as well. But as we just talked about, the markets are a leading mechanism; they've tended to bottom three months before the recession end. So, if you look at it from that vantage point, the yellow signal has come on average two months before the bottom of the S&P 500, and one month after. And this is a really important consideration. Because of the prevalence of those counter trend rallies, we've designed this dashboard to be a little bit late to the game in order to signal a green signal to help avoid whipsawing people with a false green here or there. But more importantly, if you look at the 12 months following the bottom of the seven timeframes, the S&P 500 is up on average close to 37%. So being a little bit late to the game isn't necessarily the worst thing in the world.

Now just to show you how this may work, if you look on the next slide, this is how the dashboard evolved heading of the great financial crisis. And the key point here that I want to make is that there's a big difference between a yellow signal and a green signal. We've had seven green signals in the dashboard's history. We've had seven durable economic and market recoveries. We've had a couple of timeframes where the dashboard went to yellow, the economy continued to deteriorate and went back to red. So, you obviously see it here in 2008. We've turned yellow in the beginning part of '08 but turned red in the summer but that was well before the Lehman bankruptcy. But we also had a false yellow, if you will, back in 1974 as well. So again, yellow signal, the way I like to think of it, kind of think about how you want to re-risk your portfolios, where green is really that actual signal that institutes maybe taking some action on that measure.

Now, there's a couple things that we need for a durable bottom, and I think we've seen a couple of these, and slide 17 obviously is the first one, and we've seen this happen very aggressively, not only here in the US but around the world. You can see that global monetary policy is accommodative, and this looks at the share of central banks that are currently cutting interest rates, and we're now approaching levels shown last on the financial crisis, but also back in 2001 as well. But I want to talk a little bit about what the Fed has done here, because what the Fed has done is unprecedented, and I know you're sick of hearing the word "unprecedented" because, I'm sick of saying the word "unprecedented," but it really truly is. They really impressed me with their announcement on March 23rd. They came in, they opened up, they introduced an open-ended QE program. So, in that timeframe they've added $2.5 trillion worth of bonds to their balance sheet. That is a massive amount of bonds, and maybe, put that in perspective, during the largest QE program last cycle, the biggest time that they were ever buying QE was $85 billion worth of bonds per month. You saw that back in 2013. Over the course of that year, they added $1 trillion to their balance sheet. Over just two-and-a-half months, they've added $2.5 trillion, so the Fed has stepped in very aggressively from a QE perspective, but they also supported a bunch of programs to support different debt markets that weren't operating properly. I've been saying that this is [Fed Chairman Jerome] Powell's do whatever it takes moment, similar to what you saw [European Central Bank President Mario] Draghi say back in 2012 to save the eurozone, but then again a couple of weeks after that announcement, they announced another $2.3 trillion worth of aid supporting areas that may have been overlooked or under allocated to in their initial announcement, specifically credit to small- and medium-sized businesses, a muni facility, and the inclusion of fallen angels in corporate facilities. So this is all important; this is a key reason why again, markets have moved so dramatically off the lows is because the Fed has prevented a liquidity crisis from getting into a very, very nasty situation, and I firmly believe that the Fed did not step in here, we would be looking at the next Great Depression here in the US, and they've certainly taken us away from that sort of outcome.

But on the next slide, obviously, it wasn't just the Fed working alone. They've had a lot of help from Congress, and it's obviously not the US only that's doing fiscal stimulus; you're seeing this across the globe. On the very right-hand side, you can see the contribution of global fiscal stimulus as a percent of global GDP. Policymakers have put close to 5% of stimulus into the global ecosystem. If you updated to today's numbers, this is actually about 6.2%. So, stimulus continues to come out. Looking at the CARES package specifically, it's closer to 10% of GDP, and if you look at Obama's American Recovery and Reinvestment Act, that was only 5.7% of GDP and that took place over a number, a couple of years. So, the CARES Act was the largest single-piece of legislation since FDR's New Deal. So, this in combination with what you've seen with the Fed, this amplified stimulus in the US to closer to 40% of GDP. So, this is a massive package, again a key reason why equity markets have moved higher. One of the reasons I was concerned about the fiscal package is because traditionally it's taken a long time to get money into the hands of consumers and businesses. For example, back in '01 and '08, it took the government three-and-a-half months to get people checks for stimulus, and it's no reason why, that's a very prime reason why those stimulus packages weren't successful, but obviously they have used direct deposit to get money to individuals, and the amount of money that has done out with the Paycheck Protection Program to small- and medium-sized businesses, the speed has been breathtaking. So, I do think that they've acted right; they've done exactly the right prescription of what we needed. I think we're going to need another stimulus package to tide us over when the economy starts to reopen. But again, this bull case is obviously that policymakers are not going to allow the economy to fail; they're going to provide that backstop and keep us moving forward at the end of the day.

Now the next slide I think is really important, because if you look at volatility spikes, they tend to be really good entry points. We define a "volatility spike" as an increase of volatility from one month to another of over 50%. You've seen a number of instances since 1990 when volatility actually became measurable. The key is that if you look six months after a VIX spike, the markets were up on average 9% with a positive hit rate of 89%, and obviously, the VIX rates have come down dramatically since the spike that we saw in March and the markets, not surprisingly, are up from that particular situation.

The one thing I want to talk about here is what equities are going to do well following selloffs, right? If you're bullish about the economy, or you know, if you think that the worst has passed, let's look at what sectors could have that leadership position for the upcoming year on slide 20. So again, the same seven major market drawdowns that we saw on that previous slide, you know, the 10 or 11 slides ago, but we're looking, after the bottom of that selloff, which sectors did the best in the year following that bottom. So, on the left-hand side, that's the relative performance. You saw that information technology and financials were the best-performing sectors. ITF performed on average versus the market 23%, versus financials at 15%, but looking over the right-hand side, that's the hit rate, you can see no one was 100%, but IT was the best, outperforming six out of seven times, with financials, industrials, and consumer discretionary outperforming five out of seven times apiece. A key here, I think because of the unique nature of this drawdown, because it can be more of a U-shaped recovery rather than a V-shaped recovery that we've been accustomed to. I think it's going to be really hard for a couple of these sectors to outperform. Specifically, financials and industrials. Financials, in order for them to outperform, you really need to see the ten-year treasury move up dramatically, and I think given the large deficits that we're seeing from Congress, and the fact that you are going to see probably a pretty weak acceleration of economic growth, I don't see a situation where the ten-year treasury rises dramatically from here, so if that's going to be the case, and again, you may have some bankruptcy issues, may have some solvency issues that are going to hurt the larger banks because they're going to have to ride out some of those bad loans, I think financials, even though they may outperform, if we look back from a year from the bottom, I don't think they're going to outperform to the degree that they have seen over the last seven major market drawdowns, and also industrials may have a difficult time if the global economy is going to be operating at 80 or 90%. Also, with consumer discretionary, it's going to be difficult in consumer discretionary, because you're going to have winners, and you're going to have losers. A lot of retail stores are going to be big losers, so it's going to be situation where you're going to have to pick and choose your winners, and I think that's an excellent situation for an active manager to be able to ascertain what the recovery environment is going to be, how strong is your balance sheet, can you sustain an environment where you're only getting revenues at 70 or 80%, and I think there's going to be a big separation between the winners and losers, but most importantly, I do like IT; I think IT is very well-positioned for this type of environment.

Now the next three slides I think are really important. They talk about the value of long-term investing. Now you really never want to time the market, right? If you're a long-term investor, you don't want to try to jump in and jump out of the market and time it, and I think this chart is evidence that that should be the case. So, we're looking at two hypothetical investors. They each had $100 back in 1936. They invested it in the S&P 500. However, one investor just stayed invested for the entire timeframe. The other investor was the best market timer in the world. They were able to sell their portfolio 10 months prior to a market peak, and they were able to buy back their portfolio 10 months after the trough, and you can see, even with this really good market timer that missed all of that volatility, the buy-and-hold investor had an almost two-and-a-half times return of what that buy-and-hold investor had, so buy-and-hold investor had about $22,000; the market-timer had close to $9,000.

So again, you don't want to time the market; you want to stay in the market for the long haul.

And slide 22 though should tell you that I know that we're not officially in bear market territory yet, but we were just in bear market territory very recently. We could go back to bear market territory, and I think there's probably a good chance that the markets will have a pullback here as the economy reopened, but the markets are in the bear market, don't worry about that. Because if you look, since 1928, the S&P 500 has been in a bear market, or 20% below its previous peak 39% of the time. So, bear markets are just something that you need to deal with as a long-term US equity investor. Again, we've been spoiled over the past ten years; we have not been in a bear market at all over the last ten years. But even if we have to stay in this range here until we work through to the other side, there's no reason why again you don't want to have that same exposure in US equities.

Also, in slide 23, we look at it from a different vantage point. We look at the price return of every decade, on slide 23. The price return of every decade, which is the second column there, you can see on average, per decade, you were able to get a price return of 114% per decade, but if you excluded just ten of the best days per decade. So out of 3,650 days, you exclude just ten days, your 114% return per decade drops all the way down to 44%. So, you would have seen 70% lower returns over the course of that decade on average. And if you think about these biggest moves in the market, a lot of them actually happen at the end of an economic cycle, you know, when you have that euphoric phase where the markets are moving higher, but also if you look at that second bullet points, a lot of these big up days happen at the very beginning of bull markets. 28% of the best days of the S&P 500 which we define as a 5% or more increase of a day, took place in the first two months of a bull market. Again, can't time the market; need to be a long-term investor.

Now one area that we think is attractive is slide 24, which is dividend-paying equities. Now, as of the end of the quarter, 69% of the S&P 500 now has a dividend yield greater than a 30-year treasury. That is a huge amount of stocks that pay dividend yield higher than the longest bond in the US that we issue. I think because of this dynamic, the US was an area where you did still have some sort of yield pick-up; that's no longer the case. I think because of this type of situation, you're going to have a huge demand for equities that can deliver higher dividend payments. Now obviously, I think buybacks have gotten a bad rap here; buybacks are going to be something that corporate managers may shy away from because of the negative connotation with them, so I think dividends are going to be the favored area of giving capital back to investors, but as the US continues to age, the baby boomers move into retirement, I think that creates a huge demand for dividend-paying equities, and obviously, create demand from overseas investors from Japan and Europe that have negative interest rates right now.

But the last reason why you don't necessarily want to be bearish long-term on the equity markets is slide 25. That the markets go through longer-term periods, a 10-20-year period where the market goes nowhere that's known as a secular bear market, but they're always followed by a 20-year period where the market goes up substantially, better known as a secular bull market. So, if you look all the way to the left-hand side of the chart, you had a pretty nasty secular bear market. In the 1930s and '40s, your cumulative return was negative-22%. But that gave rise to the secular bull of the '50s and '60s. Your return jumped all the way up to 450%. Of course, that bull was followed by the secular bear of the 1970s; because of high inflation, your returns were roughly flat, followed by the secular bull of the '80s and '90s where your returns jumped all the way up to 1250%. Now it's ClearBridge's perspective that we excited the secular bear of the 2000s, and we're now in year 10 of a 20-year period where you're going to have outsized equity returns. Doesn't mean you aren't going to have bumps in the road; it doesn't mean you aren't going to have recessions, but if this pattern continues which has been going on for the last 90 years, we're going to see a lot more all-time highs in US equity markets as we move through the next decade, and I always get the question, what is going to propel this secular bull market? And I think the answer is extremely easy. It was the slide that we just saw, that dividend-paying equities are quite attractive versus fixed-income and sovereign fixed-income at that, but also I think you have policymakers that are deathly afraid of Japanese-style deflation and they're willing to do whatever it takes to make sure that the economy continues to move forward, and one of those ways is to increase asset prices and cause asset reflation. Obviously, I think if you look at what the Fed and Congress has done this time, they've crossed the Rubicon; the Fed and Congress are now working together and I think any stimulus package moving forward is going to be a combination of both the Fed, and also Congress, which has not been the case really over the last 50 years, give or take. So again, if you think about this situation, I think we could have a little bit of a hangover. As we talked about at the very beginning of my comments, I think that there's going to be a persistent joblessness situation that's going to hurt consumer spending. I think that there's going to be consumers that are not comfortable coming back to their normal way of life. I think they're going to avoid anywhere that requires face-to-face transactions. They're certainly not going to go to the malls, mass gatherings like church, get on an airplane, go to a restaurant, and because of that situation, I think that is certainly going to create some air pockets as we move to the back half of this year, maybe even to the beginning of 2021, but I think once we get through the situation, maybe we get better testing, we can get a cure, so maybe some sort of vaccine, I think that obviously will be a situation where the economy comes back online and we can get back to some sort of normalcy. But until we get there, I think there's going to be some air pockets here over the next, call it six-to-nine months until we get to that point in time. This chart right in front of you I think is a very good reminder that you want to maintain your equity exposure; this is clearly the time that you want to keep your equity exposure based on this long-term trend.

So that's all the prepared comments that I have right now, but I want to do a quick trivia question with everybody. You know, think about what your answers are. So, since 1926, we've had 94 years of market returns. So, 1926, 94 years of returns. Out of those 94 years, how many times do you think that the market was up 20% or more in a given calendar year? 94 years, market's up 20% or greater. Kind of think about what that number is; maybe write it down, okay? Jonathan, I'm actually going to ask you, since I can't ask the audience live here, Jonathan, how many times do you think over the last 94 years, the markets are up 20% or more?

Jonathan Lamothe: Well thank you, Jeff. It's been a while since I think anybody's asked me a question on one of these webinars, but going with my gut, we always hear what the average return is, under 10. So, I'm going to go with 15 times.

Jeff Schulze: Fifteen, okay. Price-is-right rules, if you go over, you're wrong. Does that change your answer at all?

Jonathan Lamothe: No, I'm going to stick with 15.

Jeff Schulze: (laughs) Okay, I was trying to talk you out of it, all right. Same 94 years, how many times do you think the market's lost 20% or more? Any thoughts, Jonathan?

Jonathan Lamothe: Let's go with --

Jeff Schulze: This includes the Great Depression, mind you.

Jonathan Lamothe: Let's go with 12.

Jeff Schulze: Okay, 15 and 12? All right, well hopefully everybody listening has their answer. The answers are actually on slide 57. So out of the last 94 years, the markets have returned a 20% or greater 35 times. So, in any given year, you have roughly a 40% chance of getting 20% or greater return on your money. Those years that everybody's so scared of, those negative-20% years? Six. So again, this shows you, you know, the returns of the market, and if you're a long-term investor, no matter whether we're going through a recession, or whether valuations are high, if you have a long-term perspective, the market is your friend rather than your foe.

So, with that again, I think near-term, I think that there's going to be some hiccups. I think we could see a potential second wave. I think there is going to be a change to consumer and business behavior, which can create a little bit of a vacuum. I think there's going to be a little bit more joblessness than what's currently anticipated. But again, I think we will work through those problems here over the course of 2020. Certainly, could cause a situation where the markets pull back. We may ultimately get back to the lows that we saw in late March. I think we need a number of things to happen for that to transpire, but it wouldn't be a surprise to us if we do see a pullback somewhere in the 10 to 20% range, because we have come a long way in a short period of time, but nonetheless, it's important to keep your eye on the long-term investment horizon.

END OF AUDIO FILE

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