Perspectives

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INVESTING IN A RECESSION

A quick review of history reveals that the U.S. economy experiences a recession, on average, about every five to six years. Over the last 70 years there have been 12 of these contractions when growth in GDP turned negative. Fortunately, business cycles seem to be lengthening, and most of these recessions have been fairly short. In all instances, however, the stock market was damaged before and during these recessions, presenting a challenging environment for investors. Stocks typically decline as the market anticipates lower earnings in a contracting environment for business conditions.

The inevitability of these recessionary occurrences should always be on the mind of investors so they can be prepared. However, many are not prepared in advance; thus, the question is always, "How do I invest in a recession?" Here at Crawford Investment Counsel, we focus on earning returns over a full market cycle. That is, we strive to strike a balance between earning sound returns and being protected in the event of a downdraft in stocks or recessionary conditions. Our focus has always been on quality, a significant and often misunderstood investment characteristic which enables us to accomplish this balance. We believe quality is the best approach whether we are in good times or bad, for this characteristic helps to satisfy the objectives of preservation of capital, income, and growth.

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When thinking about how to invest in a recession, it is all about getting through it without sustaining serious damage or permanent loss of capital. That way, an investment program can be sustained and emerges on the other side in a strong position to resume participation in the upside. Quality is the best way to protect a portfolio, and bonds are the higher-quality asset category. They provide preservation of capital and negative correlation benefits to stocks in times of stress. Depending on investor objectives, owning high-quality bonds can help balance an investment program and narrow the potential range of investment outcomes.

On the stock side, quality is equally as important, for equities are inherently more risky with a much wider range of outcomes. We believe the best way to improve the likelihood of investment success is to own higher-quality, consistent, and predictable businesses that pay dividends and overlay a value-oriented stock selection criteria. This helps protect on the downside, narrows the range of potential outcomes, and makes earning a positive return more likely. And, we believe the best window into quality is a company's dividend history.

How do we define quality? For us, quality is predictability and consistency more than anything else. We like companies that give us a high degree of confidence that they will be able to execute their businesses in the future in such a way that we can grow with them and receive consistent and rising dividends along the way. Dividends and quality are inexorably linked.

For us at Crawford, the basic question of how to invest in a recession is easy to answer.

We believe the best way to invest before, during, and after a recession is in quality. In advance of a recession, investing in quality increases the chances of avoiding serious damage during the recession. And finally, we believe that staying fully invested along policy guidelines provides the best likelihood of success. Since very few are able to predict a recession, it is better to embrace this portfolio characteristic and be invested in quality.

This recession will end, but we are not sure when. In the meantime, remember that portfolio management is a process and represents an ongoing search for the best investments. Look for value, and above all, look for quality.

CRAWFORD INVESTMENT COUNSEL, INC.
600 Galleria Parkway | Suite 1650 | Atlanta, GA 30339
main 770.859.0045 | *fax* 770.859.0049
www.crawfordinvestment.com

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