



The Anatomy of a Recession

First Quarter 2025

ClearBridge



Past performance is no guarantee of future results. Financial term and index definitions are available in the appendix.

U.S. Recession Risk Indicators

- 12 variables have historically foreshadowed a looming recession
- The overall dashboard is currently signaling expansion

	December 31, 2024	September 30, 2024	June 30, 2024	
Consumer	Housing Permits	↑	●	●
	Job Sentiment	×	×	×
	Jobless Claims	↑	↑	●
	Retail Sales	↑	●	●
	Wage Growth	↑	↑	↑
Business Activity	Commodities	↑	↑	●
	ISM New Orders	●	×	●
	Profit Margins	↑	↑	↑
	Truck Shipments	●	●	●
Financial	Credit Spreads	↑	↑	↑
	Money Supply	●	●	●
	Yield Curve	●	×	×
Overall Signal	↑	↑	↑	

↑ Expansion ● Caution × Recession

Data as of Dec. 31, 2024. Sources: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, Bloomberg, CME, FactSet and Macrobond. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

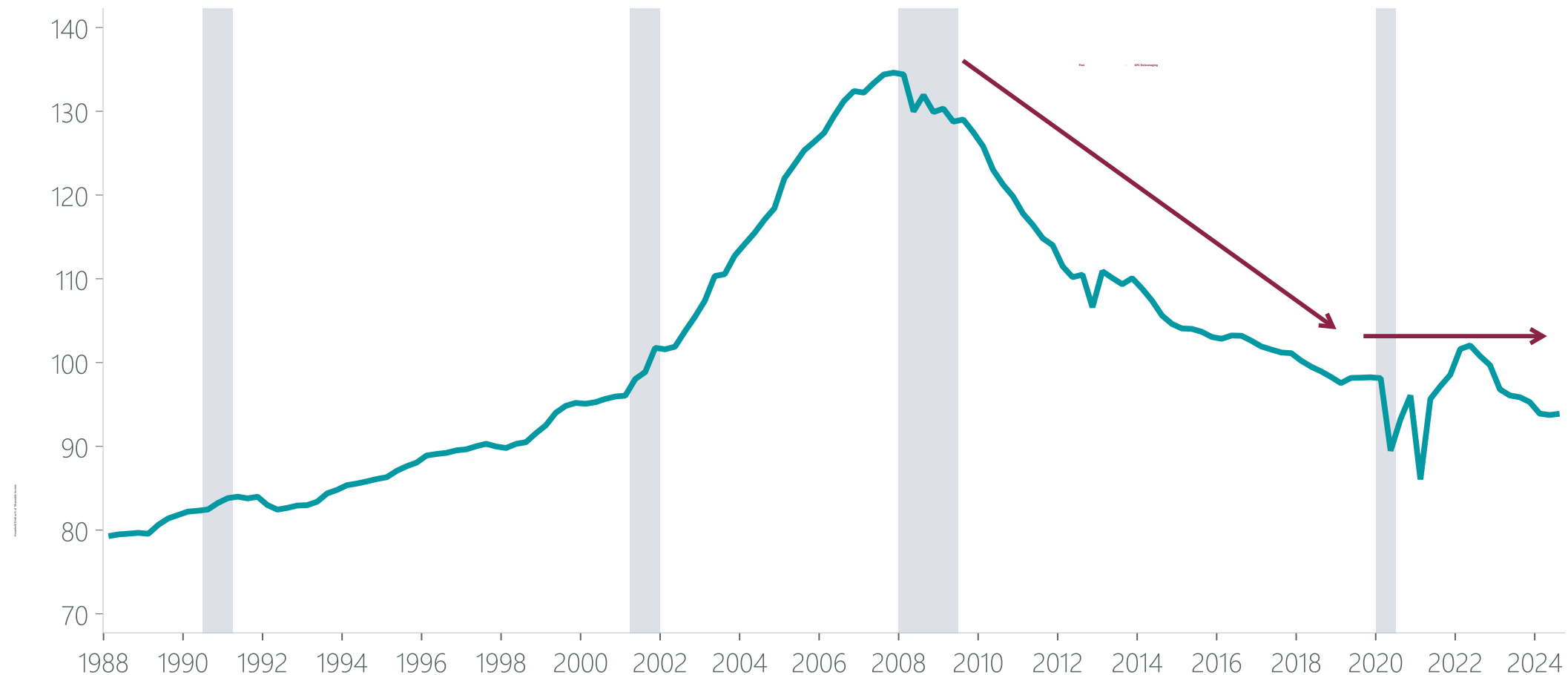
U.S. Exceptionalism: The Consumer



Sources: Eurostat, U.S. Census Bureau, Japanese Ministry of Economy, Trade & Industry, Macrobond.
Data last updated on: 10/7/2024, latest available as of Dec. 31, 2024.

- ▶ **The U.S. consumer has been a source of strength for the economy during the current cycle, with retail sales spending well above the pre-pandemic trend.**
- ▶ **This stands in contrast to other major developed economies that have seen more lackluster consumption growth.**

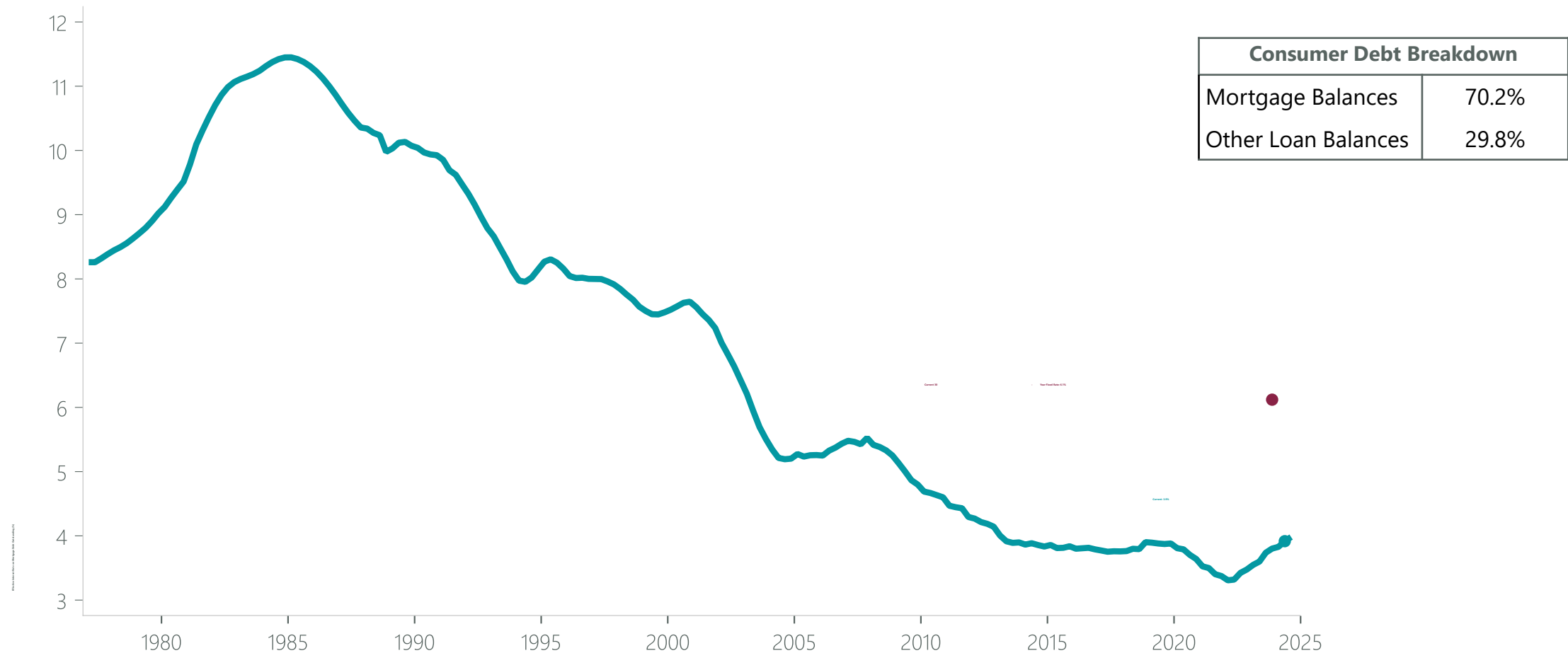
Consumer Deleveraging Done



Sources: Federal Reserve, NBER, Macrobond.
Data last updated on: 12/12/2024, latest available as of Dec. 31, 2024.

- ▶ **Consumer deleveraging efforts were a key component of slower GDP growth following the GFC.**
- ▶ **With household net worth up by \$49.4T since 2020, the U.S. consumer appears to be in a position to sustain their spending even as the economy normalizes.**

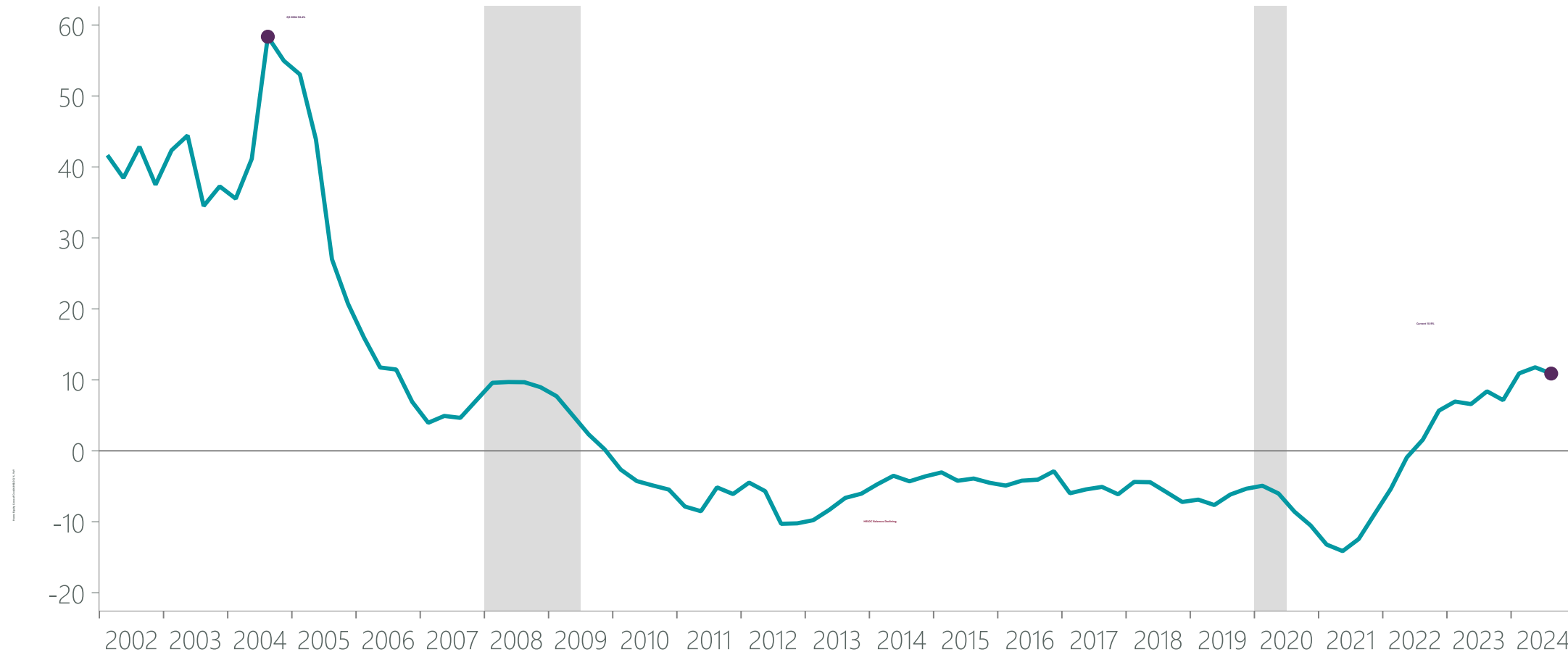
Consumers are Locked In



Sources: U.S. Bureau of Economic Analysis (BEA), Freddie Mac, Macrobond.
Data last updated on: 12/26/2024, latest available as of Dec. 31, 2024.

- ▶ **The U.S. consumer has become less interest rate sensitive since the GFC when ultra low rates encouraged greater utilization of fixed rate mortgages over floating. Mortgage debt accounts for over two-thirds of U.S. consumer borrowing.**
- ▶ **While the current 30-year fixed rate mortgage is over 6%, the average rate Americans are paying is just 3.9%.**

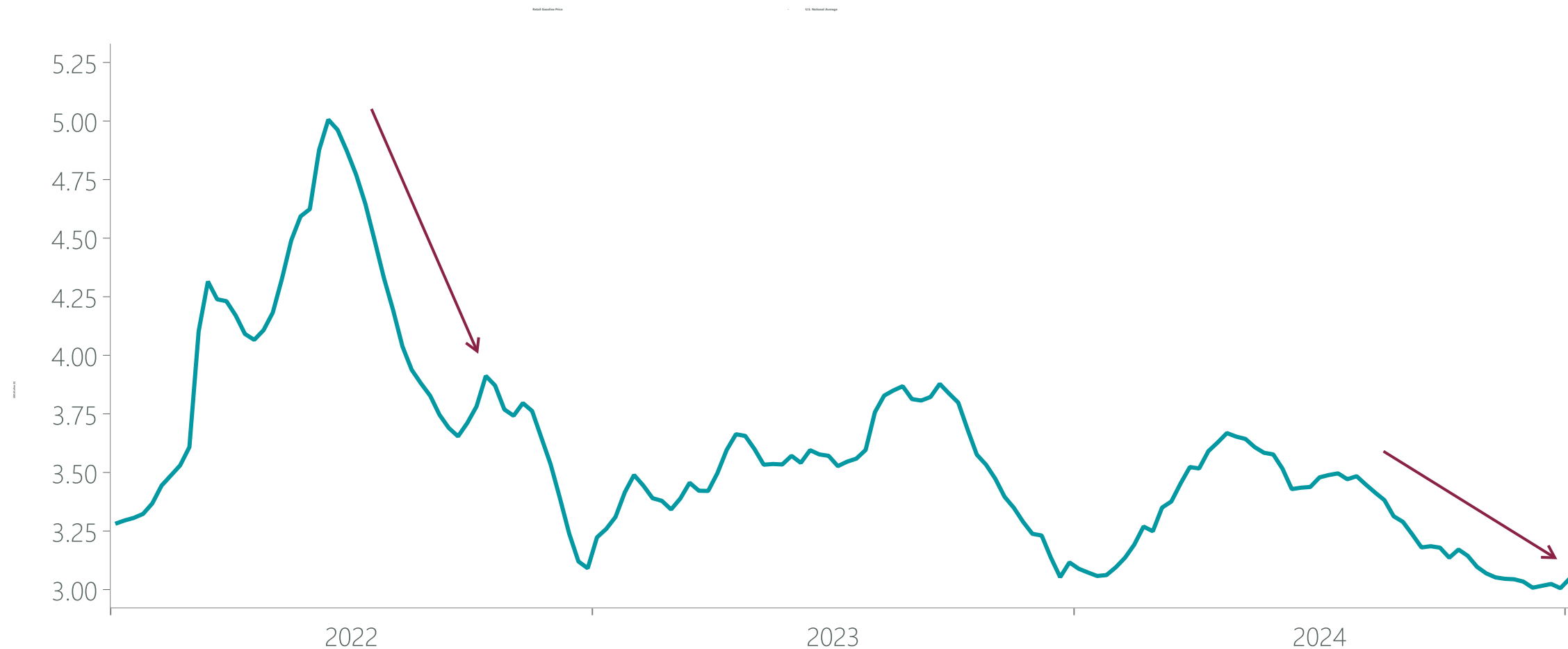
The Rainy Day Fund



Sources: Federal Reserve Bank of New York, NBER, Macrobond.
Data last updated on: 11/13/2024, latest available as of Dec. 31, 2024.

- ▶ **In the face of higher prices, consumers have begun to tap into rainy day funds such as home equity lines of credit (HELOCs).**
- ▶ **While some worry about the sustainability of consumption, HELOC balances contracted for over a decade following the Global Financial Crisis (GFC) and growth remains moderate compared with the housing bubble.**

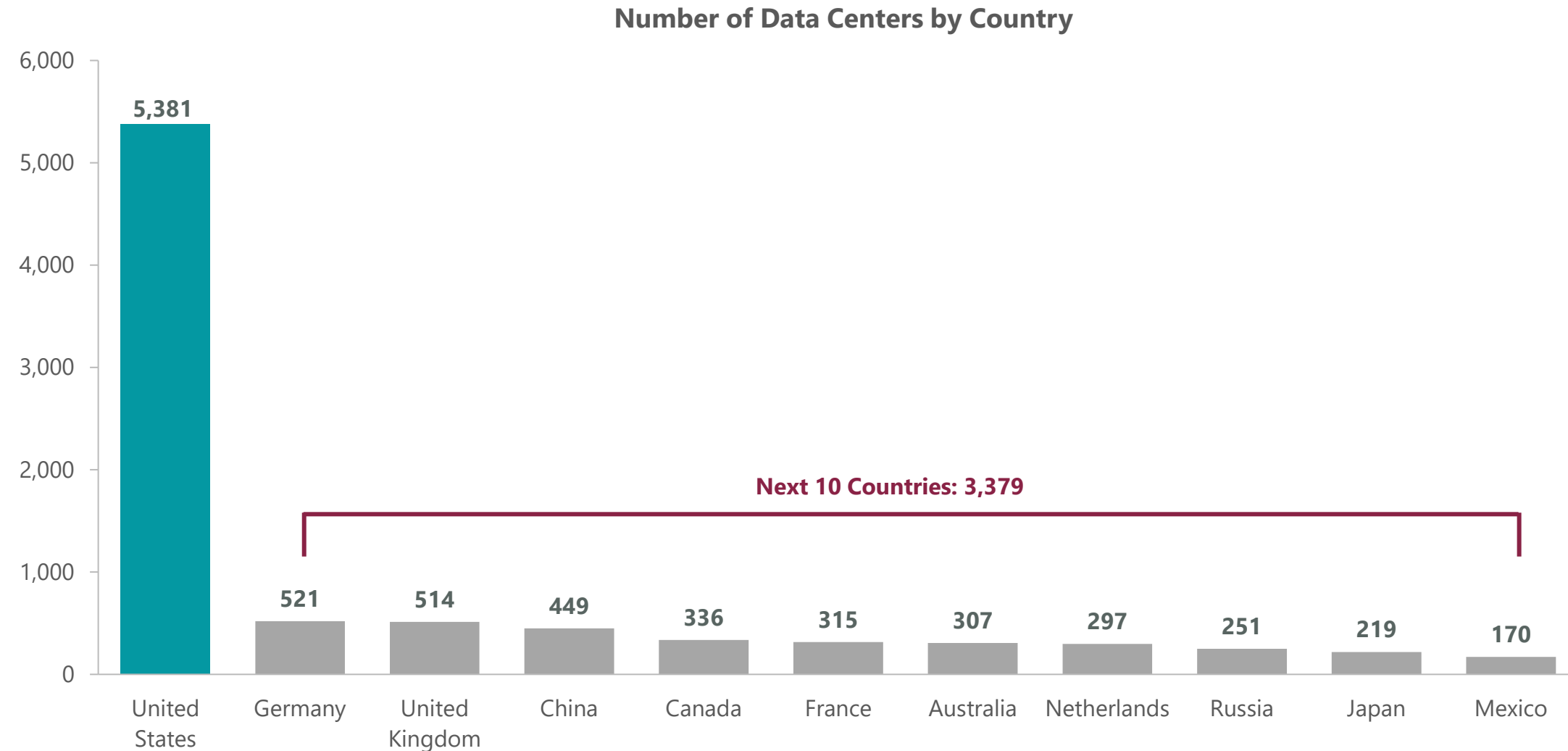
Relief at the Pump



Sources: Energy Information Administration (EIA), Macrobond.
Data last updated on: 1/7/2025.

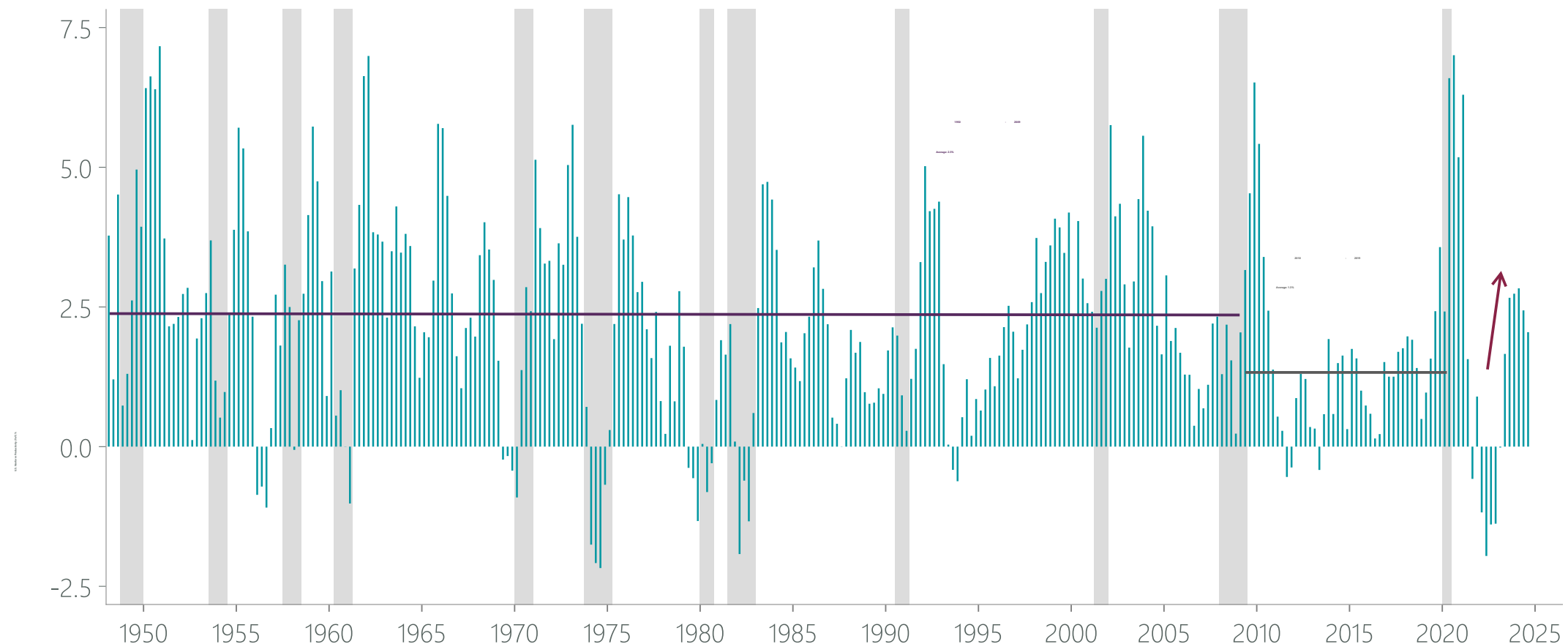
- ▶ **Following a spike above \$5 in the aftermath of Russia's 2022 invasion of Ukraine, gas prices are now approaching \$3 which should buttress consumer spending power heading in 2025.**

U.S. Exceptionalism: AI Investment Boom



- ▶ **The U.S. is the leading global destination for AI investment, outpacing the next 10 countries combined by ~2,000 data centers.**

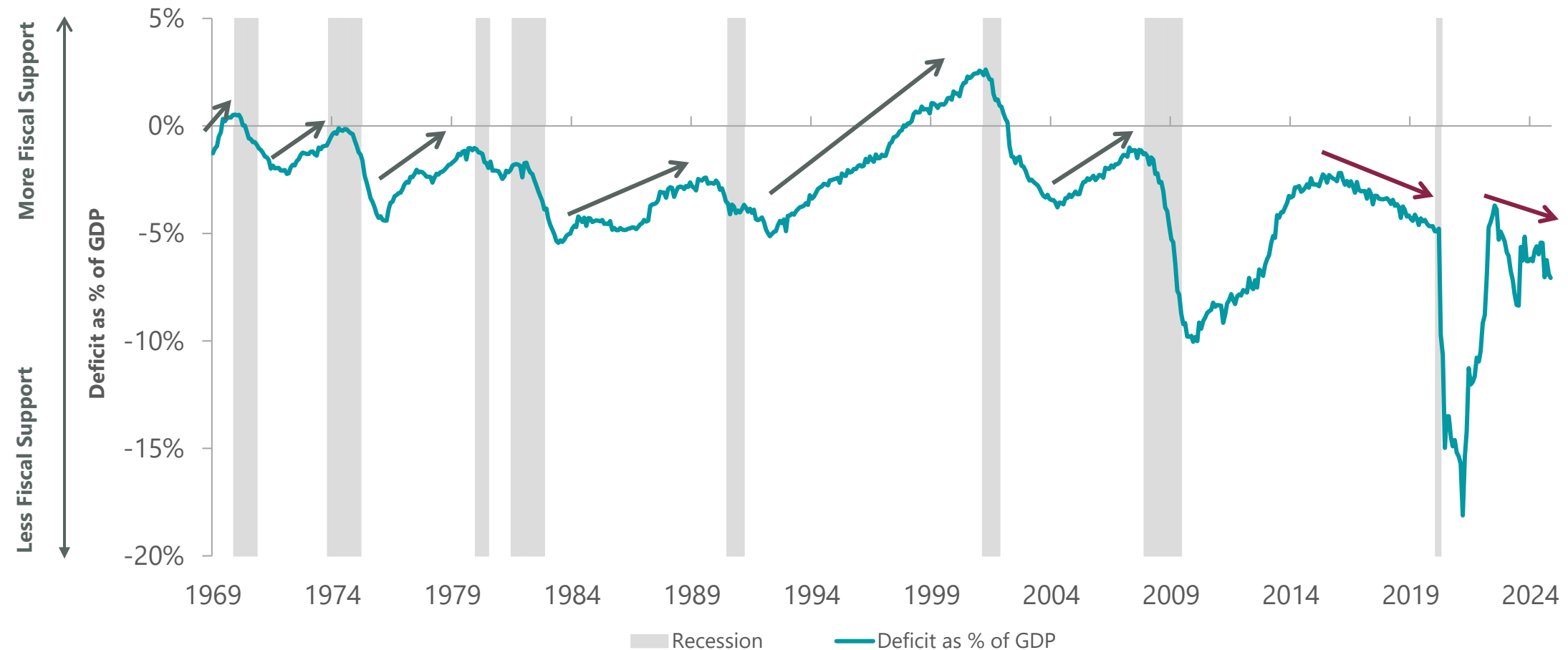
U.S. Exceptionalism: Productivity



Sources: U.S. Bureau of Labor Statistics (BLS), NBER, and Macrobond.
Data last updated on: 12/10/2024, latest available as of Dec. 31, 2024.

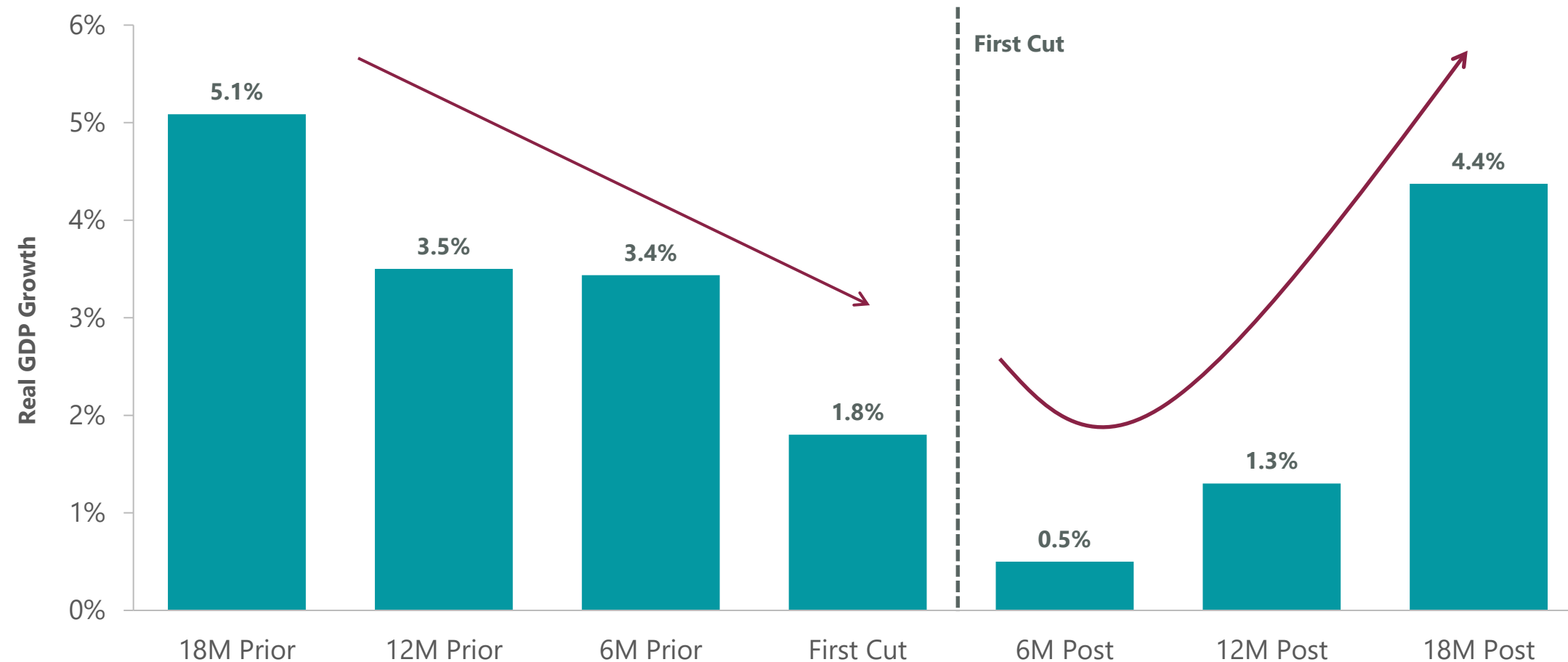
- ▶ **Productivity dropped well below the historical average in the aftermath of the GFC but has rebounded more recently and is now back in-line with the long-term average.**
- ▶ **While the benefits from AI have not yet arrived, this technology could unleash a sustained productivity wave similar to the internet revolution.**

U.S. Exceptionalism: Fiscal Support



- ▶ **The federal deficit (as a % of GDP) has been moving in a pro-cyclical manner, helping support the economy later into an expansion than has been typically seen.**
- ▶ **Although clarity is still needed regarding the new administration's fiscal spending plans, we believe this should still be a key support to economic growth in 2025.**

Economy Needs Fed Resuscitation



- ▶ **Sustained Fed cut cycles have historically led to inflections in economic growth two quarters later.**
- ▶ **With the long-awaited cutting cycle now underway, the economy should re-accelerate in 2025.**

Rate cut cycles of at least 75 bps that did not occur within broader hiking cycles. Data as of Dec. 31, 2024. Sources: BEA, Federal Reserve, FactSet. **Past performance does not guarantee future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Duck, Duck, Goose?

S&P 500 Returns After Back-To-Back 20%+ Gains (1950-Current)

Years with 20%+ Gains	S&P 500 Total Returns		
	Year One	Year Two	Year Three After Back-To-Back 20%+ Gains
1950 & 1951	30.8%	23.7%	18.2% (1952)
1954 & 1955	52.6%	32.6%	7.4% (1956)
1975 & 1976	37.0%	23.8%	-7.0% (1977)
1982 & 1983	20.4%	22.3%	6.2% (1984)
1995 & 1996	37.6%	23.0%	33.4% (1997)
1996 & 1997	23.0%	33.4%	28.6% (1998)
1997 & 1998	33.4%	28.6%	21.0% (1999)
1998 & 1999	28.6%	21.0%	-9.1% (2000)
2023 & 2024	26.3%	25.0%	???
		Average	12.3%
		% Positive	75%

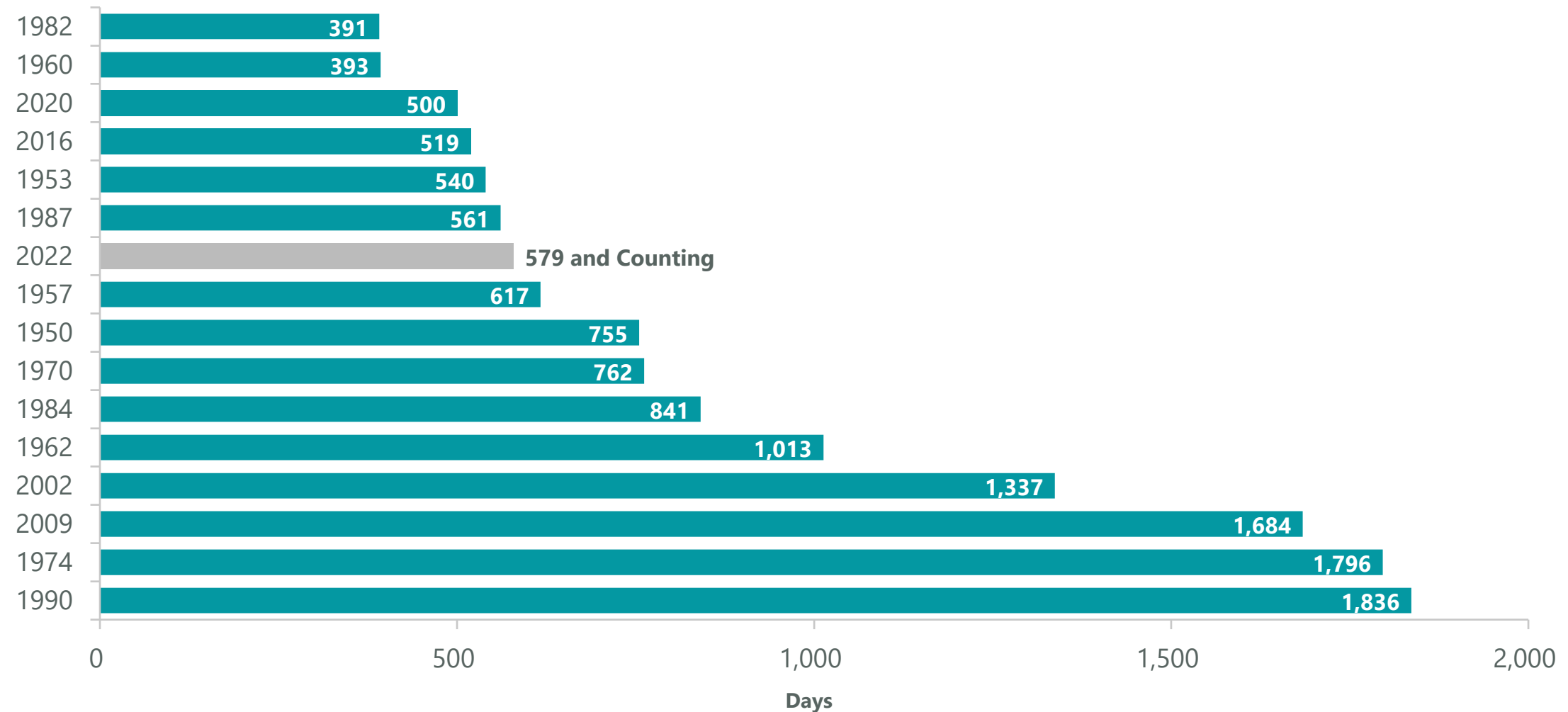
- ▶ **The S&P 500 has historically continued to deliver solid gains on balance following back-to-back 20%+ years.**

Note: Damodaran data used from 1950-1989; FactSet data used from 1990-current. Data as of Dec. 31, 2024. Sources: NYU (Damodaran Online), FactSet.

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Correction not a Foregone Conclusion

S&P 500: Trading Days without a 10% Correction



▶ **Although it has been over two years since the market's last 10% selloff, history shows this is hardly unprecedented.**

Tariff Turbulence?

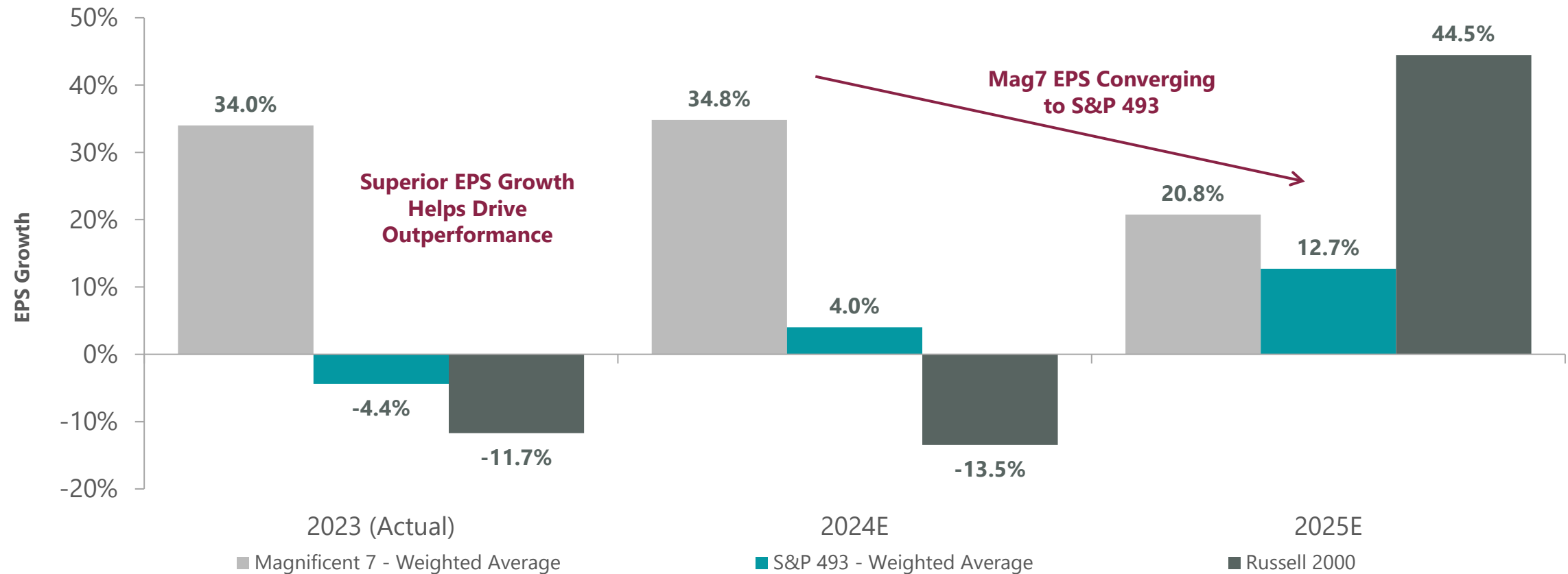


Sources: S&P Global, Macrobond. Data last updated on: 1/3/2025.

- ▶ **The S&P 500 index traded largely sideways during the period of tariff escalation during the first Trump administration.**
- ▶ **With tariffs likely to be an early priority, policy sequencing could impact how equity markets behave in early 2025.**

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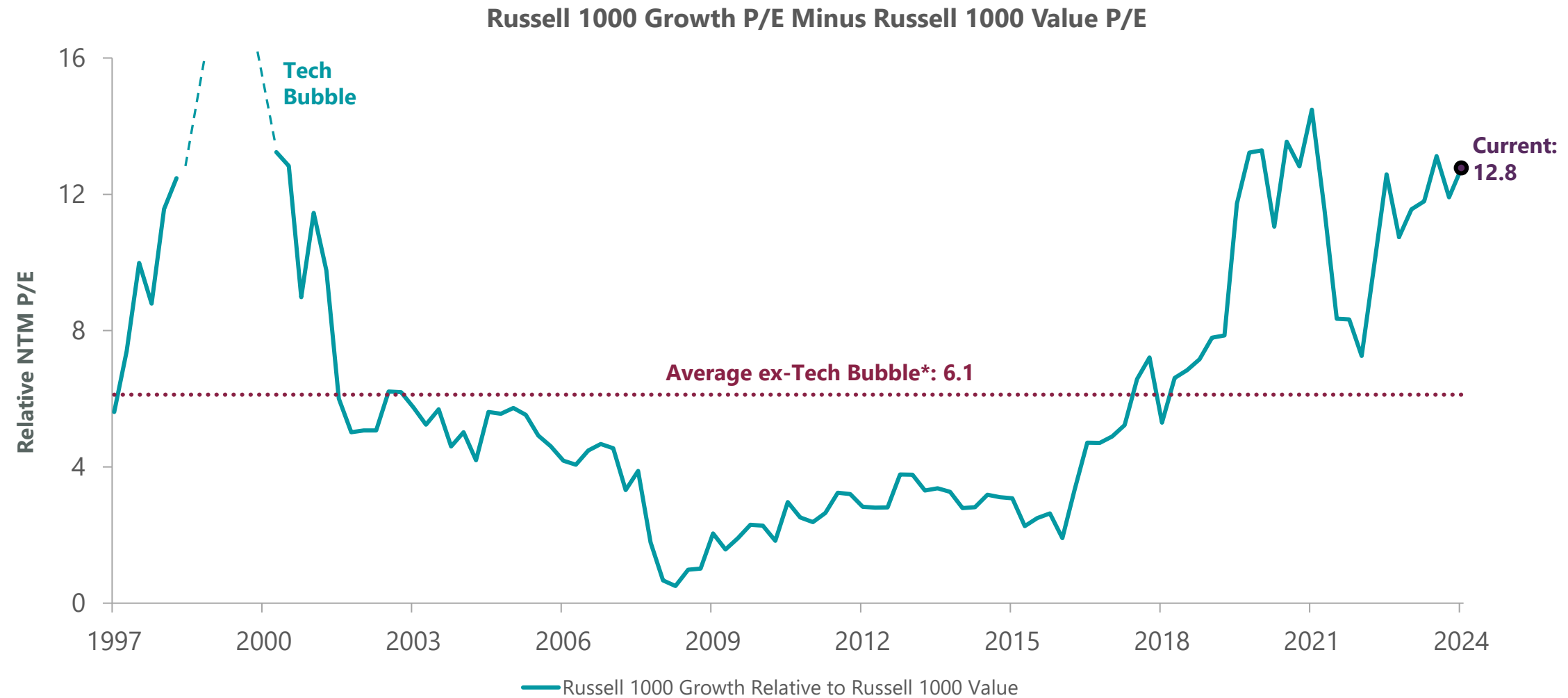
Mag7 Advantage Dissipating



- ▶ **A key driver of the Mag7 outperformance has been superior earnings growth.**
- ▶ **Bottom-up consensus expects this advantage to narrow in the coming year which could help drive broader equity market leadership.**

The term “consensus” within the capital markets industry refers to the average of earnings estimates made by professionals. Magnificent 7 data refers to the following set of stocks: Microsoft (MSFT), Amazon (AMZN), Meta (META), Apple (AAPL), Google parent Alphabet (GOOGL), Nvidia (NVDA), and Tesla (TSLA). Data as of Dec. 31, 2024. Sources: FactSet, Russell, S&P. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. There is no assurance that any estimate, forecast or projection will be realized. Company references are used for illustrative purposes and should not be construed as an endorsement of sponsorship of Franklin Templeton companies. This information is not intended as an investment recommendation, nor does it constitute investment advice.

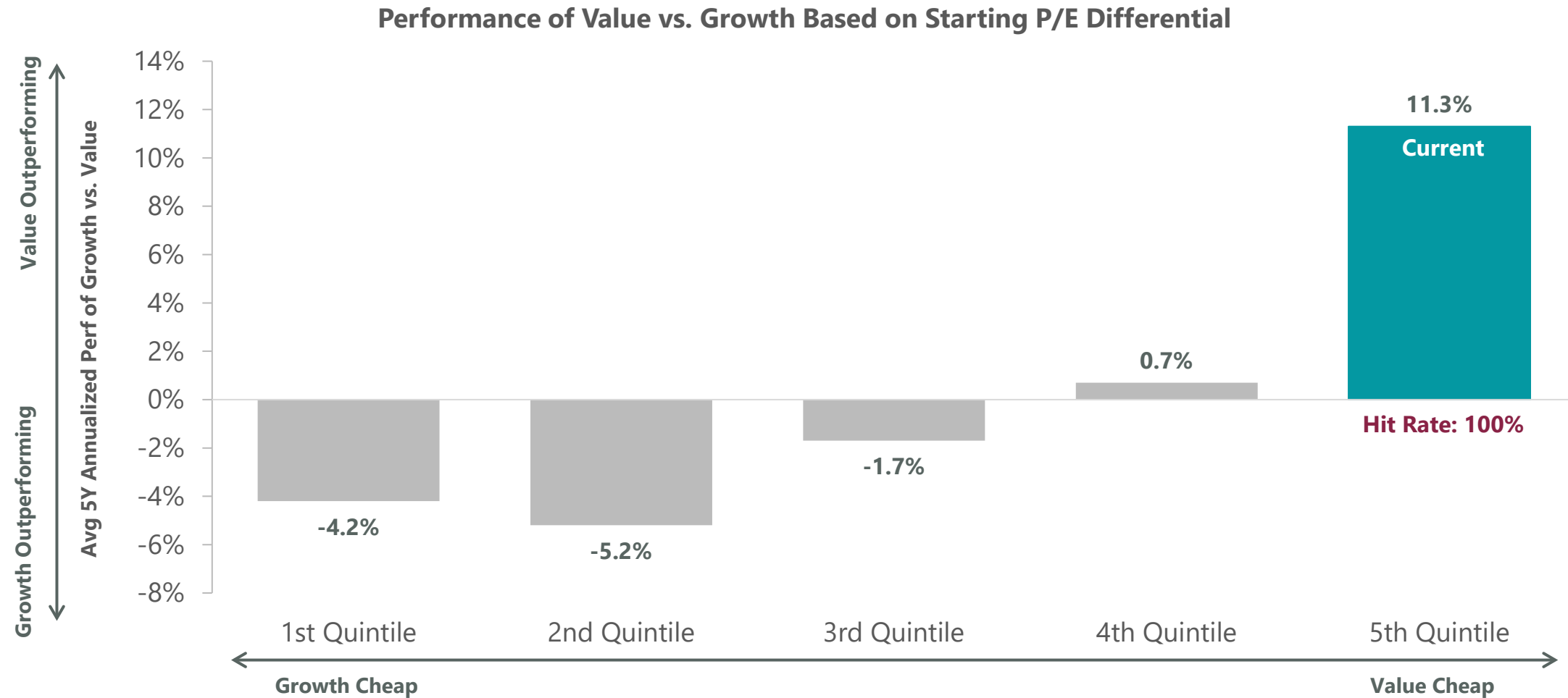
Value Not Yet Expensive



- ▶ While Value outpaced Growth by 21.6% in 2022, Growth roared back with a 31.2% advantage in 2023 and a 19.0% advantage in 2024, once again driving the valuation differential to an extreme.

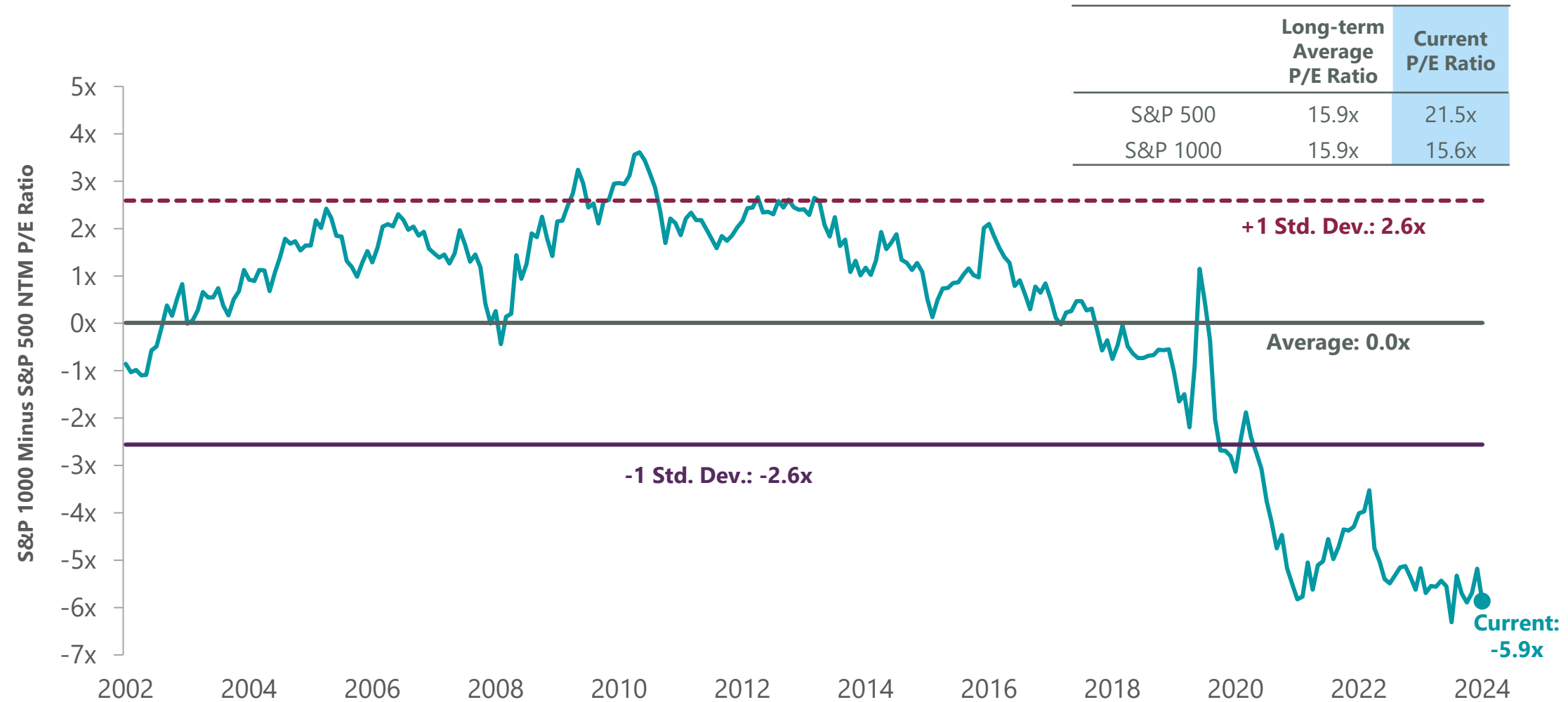
Note: Price Return. NTM = Next 12 Months. *The Tech Bubble period removed from the chart is from June 30, 1999 through Dec. 31, 2000. Data as of Dec. 31, 2024. Sources: FactSet, Russell. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

The Value Proposition



- ▶ Value has historically outperformed Growth by a healthy margin when the valuation gap (P/E differential) has reached the top quintile, as is currently the case.

SMID Caps on Sale



- ▶ **Small- and mid-cap stocks have historically traded at similar multiples to large.**
- ▶ **With large caps leading since the pandemic, the valuation discount for small and mid is near the widest in over two decades.**

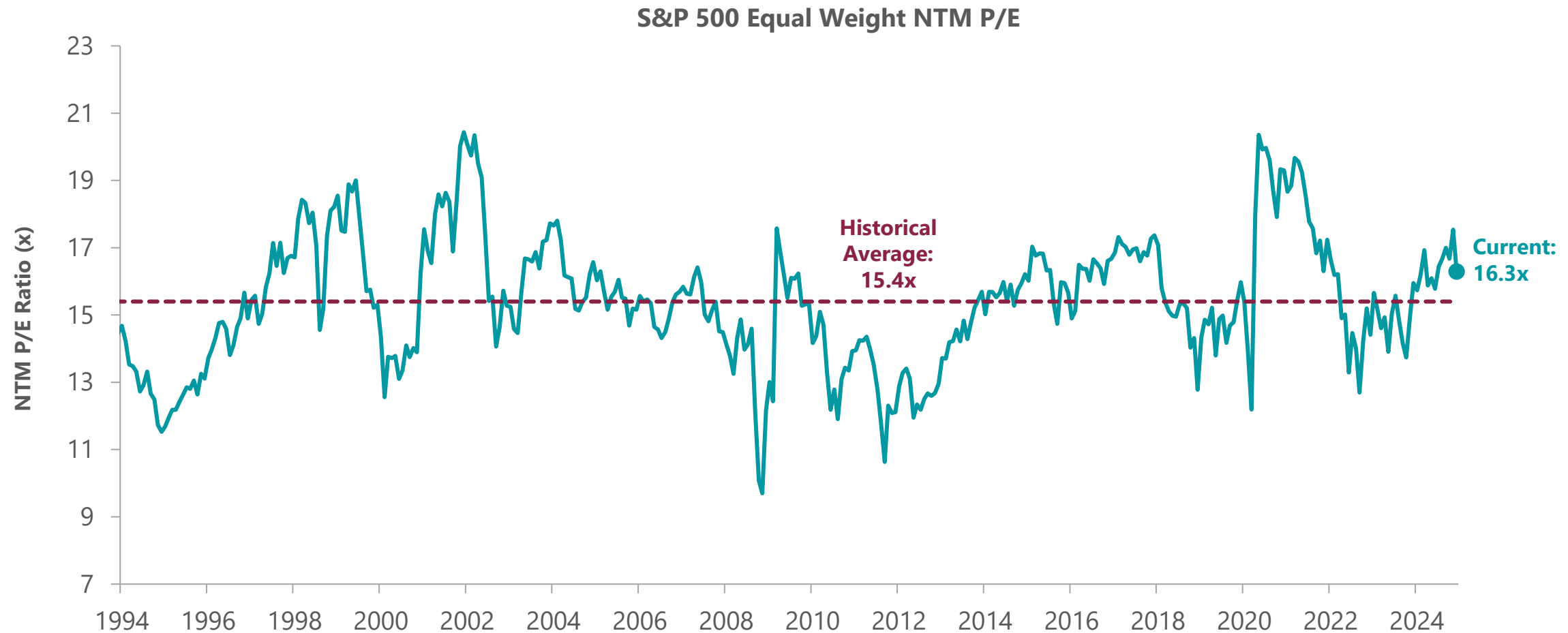
Largest Stocks Distorting Valuations



- ▶ **The largest stocks in the S&P 500 trade at a significant premium, which is distorting the broader benchmark's valuation.**
- ▶ **The typical stock (other 490) trades at a more reasonable valuation, closer to historical averages.**

NTM = Next 12 Months. Data as of Sept. 30, 2024. Source: UBS. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

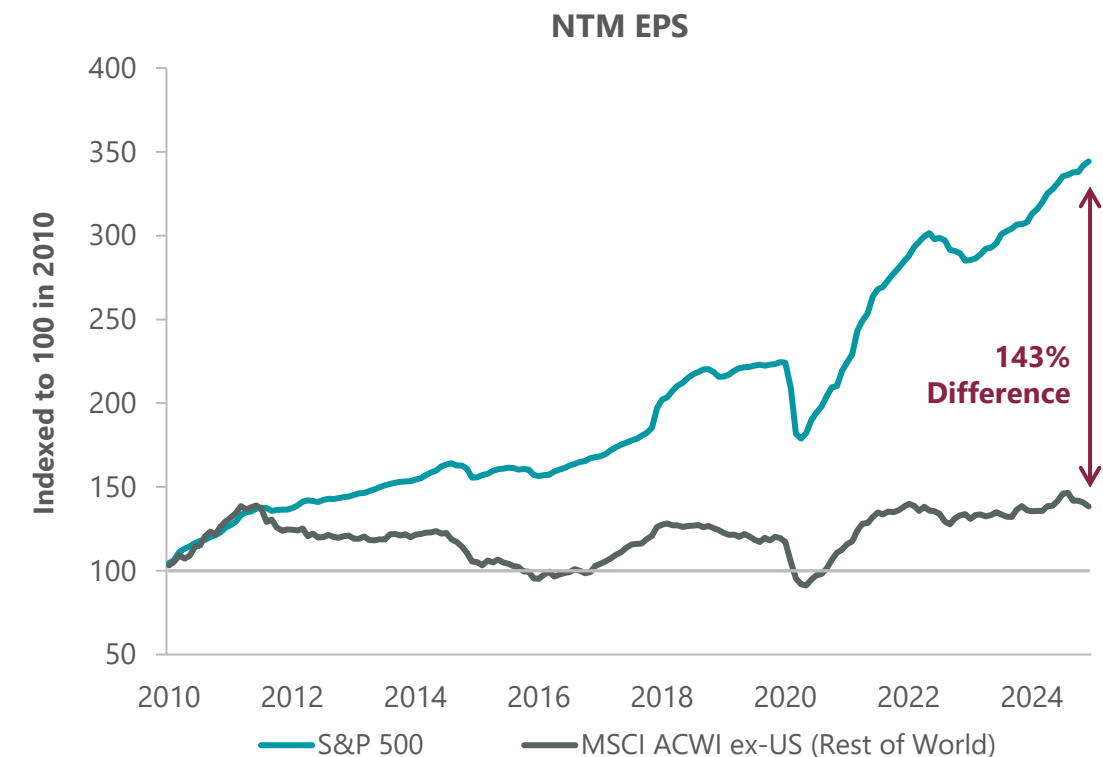
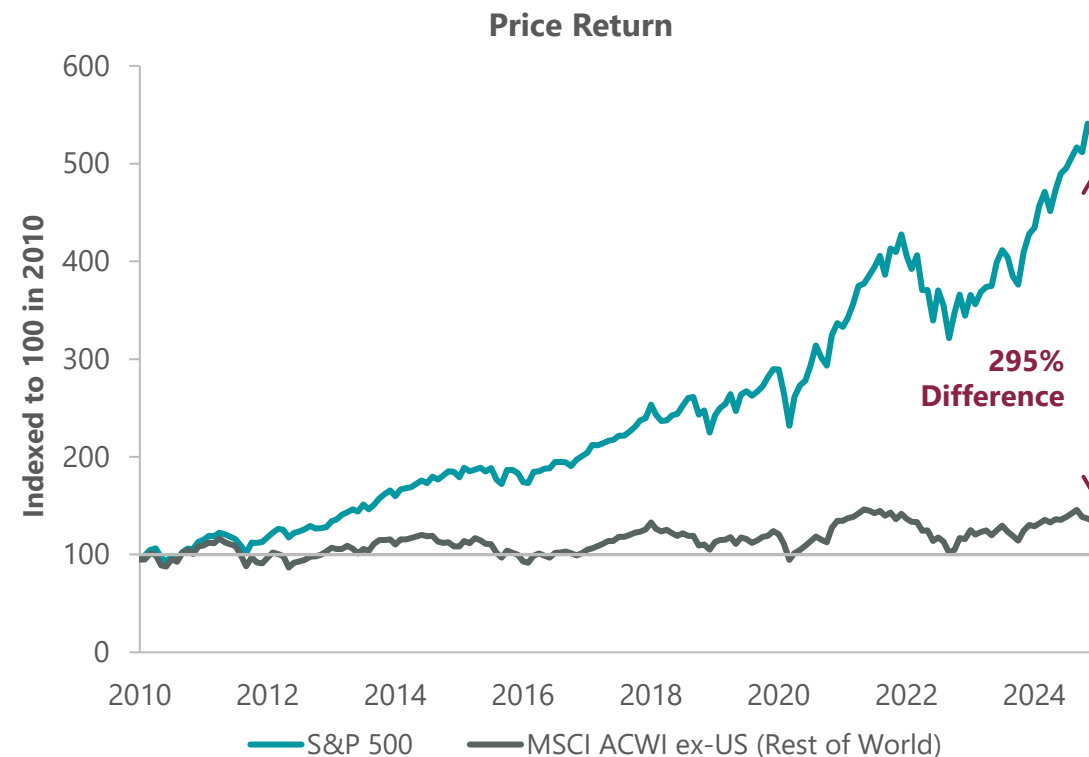
Average Stock Valuation Is... Average



- ▶ Although index valuations appear extended for the cap-weighted S&P 500, this is largely a function of a handful of the largest constituents.
- ▶ The typical stock trades at a modest premium relative to history as evidenced by the valuation of the equal-weight S&P 500.

NTM = Next 12 Months. Data as of Dec. 31, 2024. Source: UBS. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

U.S. Exceptionalism: Earnings



- ▶ **While the U.S. equity market has substantially outperformed the rest of the world since the GFC, much of this has been a function of superior earnings growth.**

NTM = Next 12 Months. Data as of Dec. 31, 2024. Sources: FactSet, MSCI, S&P. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Equity Leadership Following the Cut

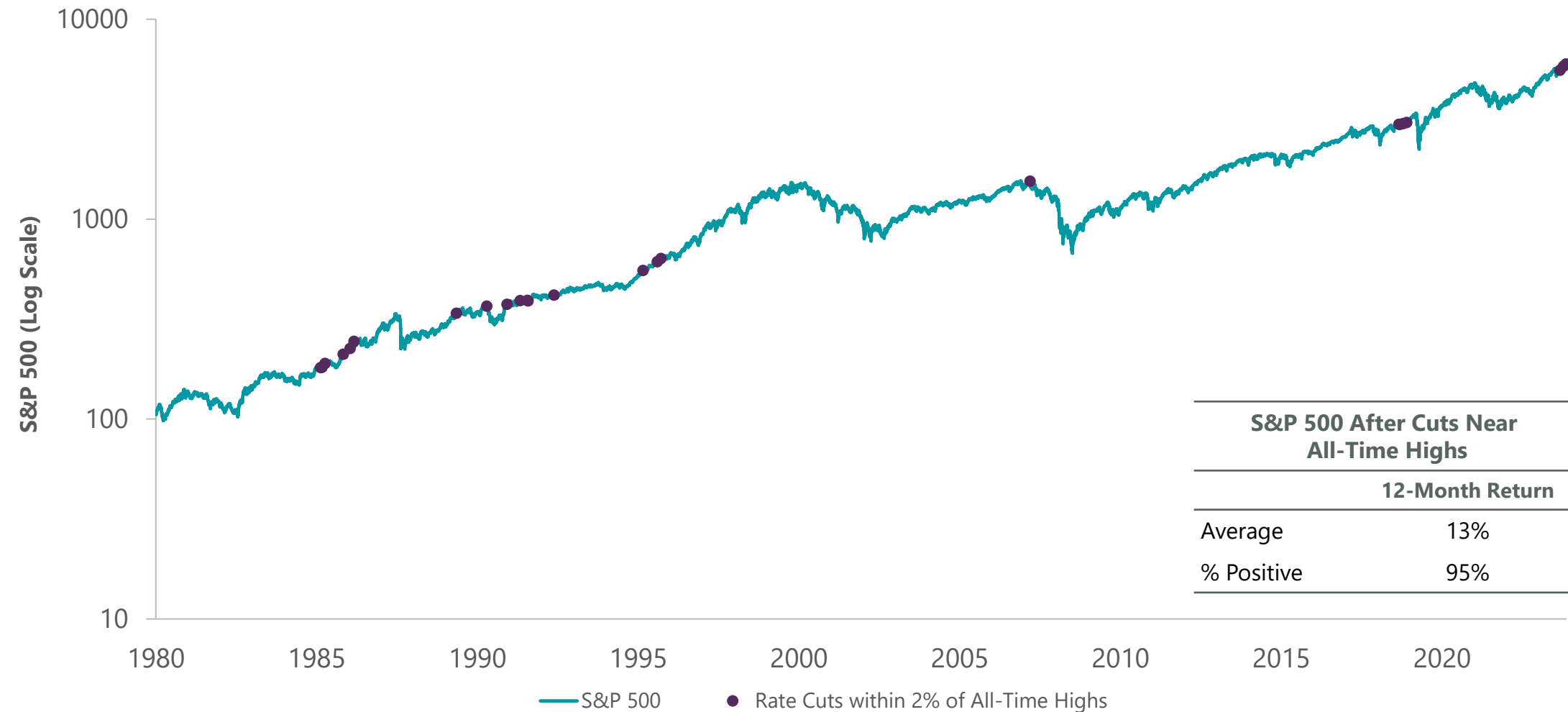
Subsequent 12-Month Price Return

Initial Rate Cut	Economic Outcome	Cash (3M T-Bills)	Russell 1000 Growth	Russell 1000 Value	Russell Mid Cap	Russell 2000
Apr. 1980	Recession	13.5%	39.0%	30.1%	51.41%	66.3%
June 1981	Recession	15.9%	-18.4%	-15.2%	-18.35%	-20.5%
Oct. 1984	Soft Landing	8.9%	9.5%	10.8%	11.96%	8.5%
June 1989	Recession	8.7%	17.5%	4.2%	4.50%	-1.5%
July 1995	Soft Landing	5.5%	22.5%	18.2%	17.26%	19.1%
Jan. 2001	Recession	4.4%	-15.6%	-5.7%	-3.08%	5.3%
Sept. 2007	Recession	3.2%	-17.6%	-25.4%	-19.29%	-12.8%
July 2019	Recession	1.5%	24.9%	-9.2%	-0.71%	-5.7%
Average		7.7%	7.7%	1.0%	5.5%	7.3%
Recessionary Average		7.8%	5.0%	-3.5%	2.4%	5.2%
Soft Landing Average		7.2%	16.0%	14.5%	14.6%	13.8%

- ▶ **Cash and large cap growth stocks have historically performed best following the commencement of a rate-cutting cycle.**
- ▶ **Rate cuts that preceded soft landings have historically given way to substantial equity outperformance compared with cash.**

Note: rate cut cycles of at least 75 bps. Sources: FactSet, Bloomberg, S&P, Russell, ICE BofA, NBER. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. For illustrative purposes only and not reflective of the performance or portfolio composition of any Franklin Templeton fund.

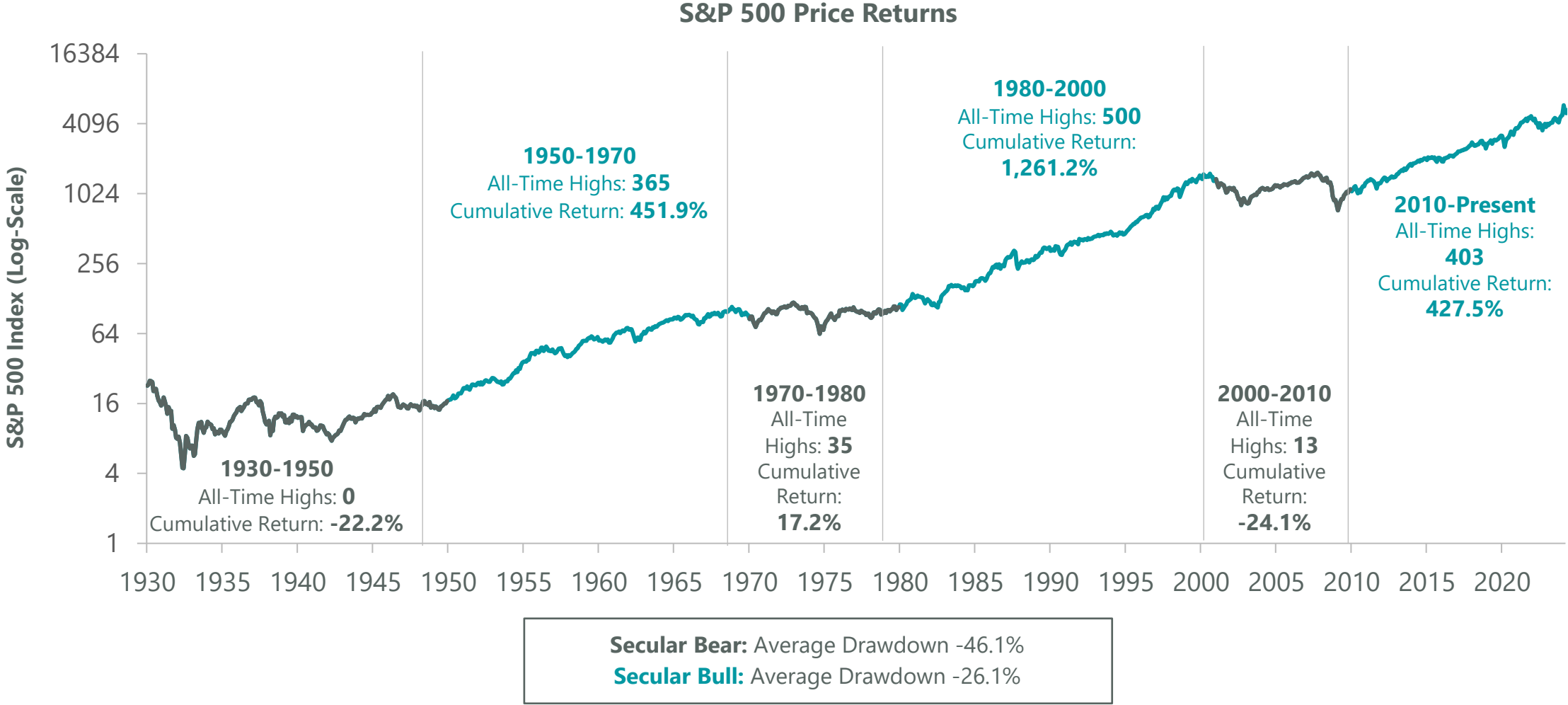
Cuts Near All-Time Highs a Good Omen



- ▶ **Equities have historically continued to move higher in the year following historical Fed cuts that came with the S&P 500 near All-Time Highs.**

Data as of Dec. 31, 2024. Sources: FactSet, Federal Reserve, S&P. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

New Secular Bull Market?



► **In the 12 months following an all-time high, stocks have historically been up 8.3% on average with positive returns 70% of the time.**

Secular bear market average drawdown includes selloff beginning September 1929. Data as of Dec. 31, 2024. Sources: Bloomberg, FactSet. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Economic and Market Summary

First Quarter 2025

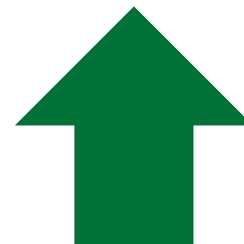
U.S. Economic Outlook

- The U.S. economy is on solid footing having defied expectations once again in 2024. The overall signal from the ClearBridge Recession Risk Dashboard is firmly in green “expansion” territory.
- Several of the key drivers behind superior U.S. economic growth remain intact heading into 2025 including a robust consumer, strong productivity gains, and a supportive fiscal/monetary policy backdrop.
- The Fed lowered short-term rates by 100bps in 2024 which should help bolster economic resilience. The magnitude of rate cuts has already eclipsed what was necessary to achieve a soft landing in the 1990s.

U.S. Market Outlook

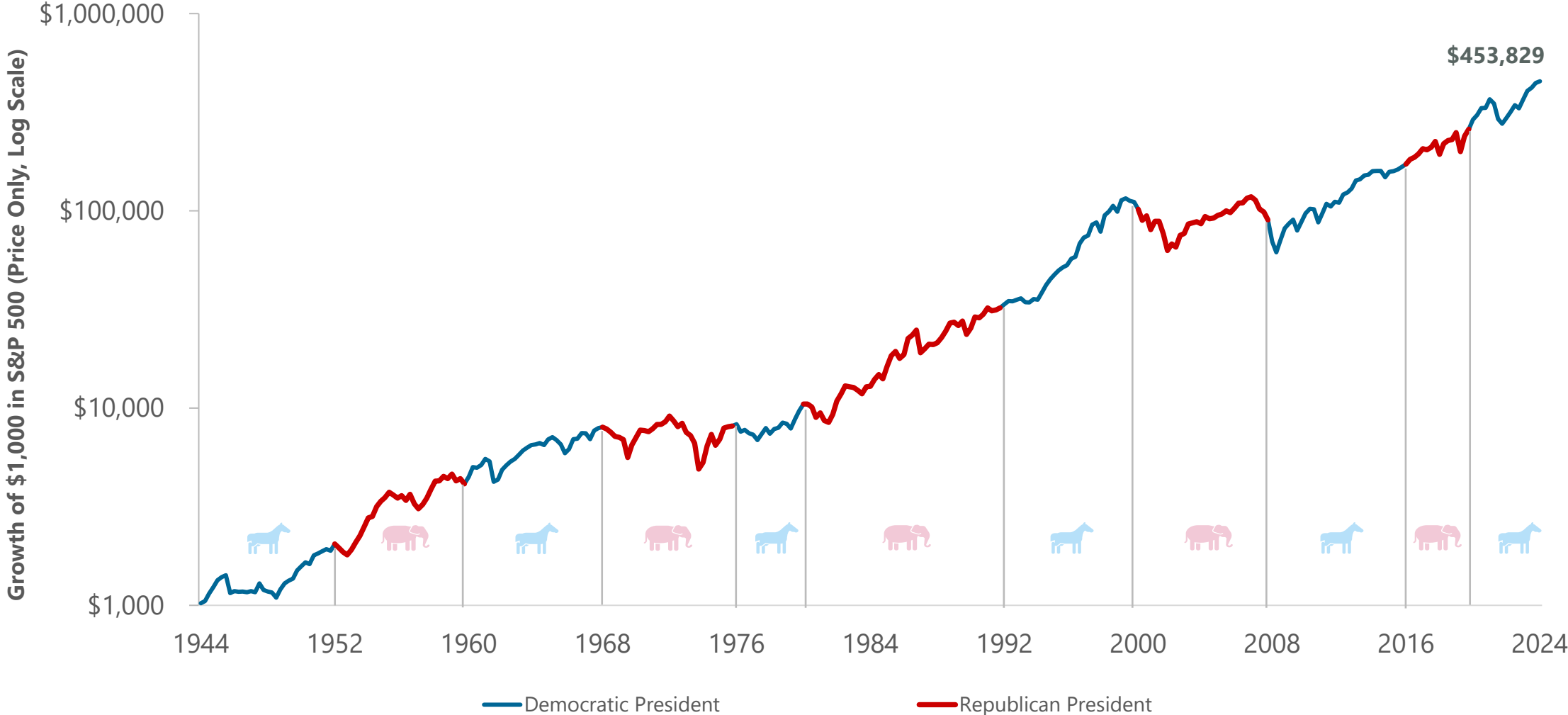
- After two consecutive 20%+ years for the S&P 500, history suggests that further upside may lie ahead with the market advancing 12.3% on average.
- Period of digestion would not be surprising given the strength of the recent rally with potential catalysts including tariffs and euphoric sentiment, among others. With recession risks muted, any weakness could represent an opportunity for long-term investors.
- A narrow group of stocks once again powered a majority of the S&P 500’s return last year. This is unlikely to be repeated as broadening earnings growth should help areas that have lagged over the past few years.

Recession Dashboard Overall Signal



Expansion

Don't Mix Politics and Investing



▶ **Historically, the equity market has moved higher irrespective of which party occupies the Oval Office.**

Data as of Dec. 31, 2024. Sources: FactSet, S&P. **Past performance is not a guarantee of future results.** Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Glossary of Terms

BEA: Bureau of Economic Analysis

Bloomberg US Aggregate Bond Index: an unmanaged index of U.S. investment-grade fixed-income securities.

Bloomberg US Corporate Investment Grade Bond Index: an unmanaged index of U.S. investment-grade corporate bond securities.

Bloomberg Global Aggregate Total Return Index: measure of global investment grade debt from a multitude of local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

CPI (Consumer Price Index): measure of the average change in U.S. consumer prices over time in a fixed market basket of goods and services as determined by U.S. Bureau of Labor Statistics.

EPS (Earnings per Share): the portion of a company's profit allocated to each outstanding share of common stock.

Fed (Federal Reserve Board): the U.S. central bank, responsible for policies designed to promote full economic growth, full employment, and price stability.

GDP: Gross Domestic Product

GFC (Great Financial Crisis): the severe economic and market downturn experienced in 2007-2008.

Home Sales Median Price: measures the price at which half of existing homes sold for more and half sold for less.

MSCI All Country Asia Index: unmanaged index of large and mid cap stocks across Developed Markets countries and Emerging Markets countries in Asia.

MSCI EM Index: unmanaged index of large- and mid-cap stocks in 27 emerging market countries.

MSCI Europe Index: unmanaged index of large- and mid-cap stocks across 15 Developed Markets (DM) countries in Europe.

MSCI EAFE Index: unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia.

MSCI Germany Index: unmanaged index of large- and mid-cap stocks across the German market.

MSCI Japan Index: unmanaged index of large- and mid-cap stocks across the Japanese market.

MSCI UK Index: unmanaged index of large- and mid-cap stocks across the UK market.

MSCI USA Index: unmanaged index of US large- and mid-cap equity securities.

NAREIT All-Equity REITS Total Return Index: free-float-adjusted market capitalization weighted index that includes all tax qualified REITS listed in the NYSE, AMEX and NASDAQ National Markets.

NFIB (National Federation of Independent Business): a U.S. small business advocacy association, representing over 350,000 small and independent business owners.

NFIB Small Business Optimism Index: measure of small business sentiment produced by the National Federation of Independent Business based on its monthly survey of small business owners.

P/E Ratio: Price/Earnings ratio

Glossary of Terms

PMI: Purchasing Manager's Index

Russell 1000 Index: a subset of the Russell 3000 Index that includes approximately 1,000 of the largest companies in the U.S. equity universe.

Russell 1000 Growth Index: unmanaged index of large-cap stocks chosen for their growth orientation.

Russell 1000 Value Index: unmanaged index of large-cap stocks chosen for their value orientation.

Russell 2000 Index: unmanaged index of small-cap stocks.

Russell 2000 Growth Index: unmanaged index of small-cap stocks chosen for their growth orientation.

Russell 2000 Value Index: unmanaged index of small-cap stocks chosen for their value orientation.

Russell Mid Cap Index: unmanaged index consisting of the 800 smallest companies in the Russell 1000 Index.

Russell Mid Cap Growth Index: unmanaged index of mid-capitalization U.S. equities that exhibit growth characteristics.

Russell Mid Cap Value Index: unmanaged index of mid-capitalization U.S. equities that exhibit value characteristics.

Sahm Rule: The Sahm Rule identifies signals related to the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to its low during the previous 12 months.

S&P MidCap 400 Index: unmanaged index of 400 US mid-cap stocks

S&P 400 Growth Index: unmanaged index of mid-cap stocks having higher price-to-book ratios relative to the S&P 400 MidCap as a whole.

S&P 400 Value Index: unmanaged index of mid-cap stocks having lower price-to-book ratios relative to the S&P 400 MidCap as a whole.

S&P 500 Growth Index: unmanaged index of large-cap stocks selected based on sales growth, the ratio of earnings change to price and momentum.

S&P 500 Value Index: unmanaged index of large-cap stocks selected based on the ratios of book value, earnings, and sales to price.

S&P 600 Index: unmanaged index of 600 US small-cap stocks

S&P 600 Growth Index: unmanaged index of US small-cap growth stocks, selected based on sales growth, the ratio of earnings change to price, and momentum.

S&P 600 Value Index: unmanaged index of US small-cap value stocks, selected based on ratios of book value, earnings, and sales to price.



S&P 500 Index: Unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.

Yield Curve: Comparison of interest rates at a point in time of bonds with equal credit quality but different maturity dates.

YoY: Year Over Year

U.S. Treasuries: Direct debt obligations issued and backed by the "full faith and credit" of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity. Unlike U.S. Treasury securities, debt securities issued by the federal agencies and instrumentalities and related investments may or may not be backed by the full faith and credit of the U.S. government. Even when the U.S. government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting from declines in the market value of these securities.

Biographies

Name and Position	Industry Experience	ClearBridge Tenure	Education, Experience and Professional Designations
 <p data-bbox="381 423 745 524">Josh Jamner CFA Director, Investment Strategy Analyst</p>	15 years	• Joined ClearBridge in 2017	<ul style="list-style-type: none">• Member of the CFA Institute• RBC Capital Markets - Assistant Vice President, Associate Strategist - U.S. Equity• Bessemer Trust - Assistant Vice President, Client Portfolio Analyst• BA in Government from Colby College
 <p data-bbox="381 704 695 841">Jeffrey Schulze CFA Managing Director, Head of Economic and Market Strategy</p>	19 years	• Joined ClearBridge in 2014	<ul style="list-style-type: none">• Member of the CFA Institute• Lord Abbett & Co., LLC – Portfolio Specialist• BS in Finance from Rutgers University

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