If a recession is looming should I invest?

The slowdown in the UK economy may have you wondering whether this is a good time to be investing in the stock market. Warnings of a recession are unsettling, but our analysis shows it is far better to maintain a long-term view than try to avoid market dips.

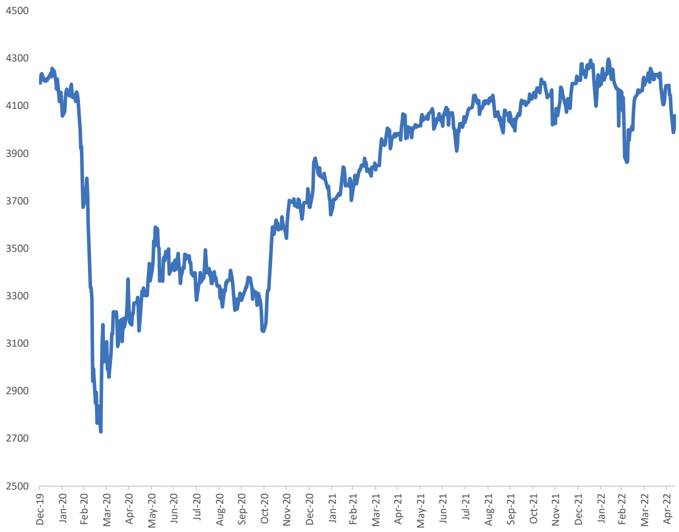
Read on to find out why attempting to time the market is risky, and what you can do to protect your investments in challenging times.

How recessions affect stock markets

Recessions, defined as two consecutive quarters of shrinking gross domestic product (GDP), are commonly associated with falling stock markets. However, the two don't necessarily happen in tandem. Market selloffs typically occur well ahead of recessions being officially announced, and they often recover well in advance too. This is because economic data is largely backward-looking whereas markets tend to be forward-looking. Basing your investment decisions on what's happening in the news right now is unlikely to reap rewards because, very often, this will have already been priced into valuations.

The most recent recession occurred in 2020, when the coronavirus pandemic sparked lockdowns in the UK and Europe. The FTSE All Share plunged in February and March, yet it wasn't until August, when data showed GDP had fallen by 2.2% and 20.4% in the first and second quarters, that the UK was confirmed to have been in a recession. By then, the index had already bounced back and anyone who had sold out of their investments would have risked missing out on these subsequent sharp gains.

FTSE All Share (price index)



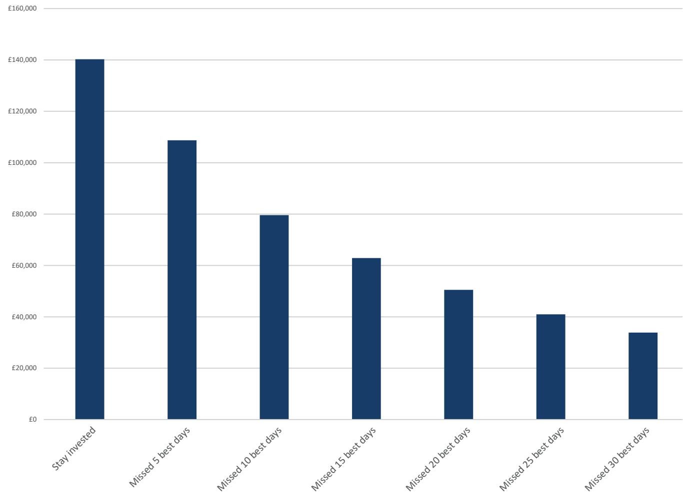
Source: Refinitiv Datastream

The dangers of timing the market

Recession or no recession, trying to time the market is almost impossible. In an ideal world, you would 'buy the dips'; in reality, there is no way of really knowing whether the stock market has reached rock bottom and when the recovery will occur. The practice 'buy low, sell high' is something that only professional investors should attempt. Do it wrong and you could miss the market's best days, ending up significantly worse off.

The chart below shows the impact of missing the market's best days on a £10,000 investment in the FTSE All Share between May 1989 and April 2022. If you kept your £10,000 invested throughout, it would have grown to £140,287 by the end of the period, assuming dividends were reinvested and before fees. However, if you tried to 'buy low, sell high' and missed the market's 30 best days, your investment would have increased to just £33,872.

Impact of missing the market's best days on a £10,000 investment over three decades



Source: Brewin Dolphin / Refinitiv Datastream

Total returns of the FTSE All Share between 1 May 1989 and 28 April 2022 based on a £10,000 initial investment, with the assumption that all dividends are reinvested.

Focus on your long-term goals

Rather than trying to time the market, a much better tactic is to stay focused on your long-term goals. Recessions are a normal (albeit unnerving) part of investing. It remains true that investing offers the potential for greater returns than cash over the long term.

The best way to mitigate the impact of stock market falls is to spread your money across a range of asset classes and sectors, in accordance with your needs and attitude to risk. Different asset classes and sectors tend to perform differently to one another in a range of market conditions, which can help to smooth portfolio performance over the long term. Managing a well-diversified investment portfolio on your own isn't easy, and that's where getting some advice can help.

The value of investments, and any income from them, can fall and you may get back less than you invested. Neither simulated nor actual past performance are reliable indicators of future performance. Performance is quoted before charges which will reduce illustrated performance. Information is provided only as an example and is not a recommendation to pursue a particular strategy.