



## An Easy Way to Understand a Recession

### Description

The news is buzzing with warnings of recession, creating panic and a selloff in the stock market. Those who experienced the Great Recession of 2008-09 know what a recession does to your finances. A recession reduces an average individual's ability to take risks and be financially flexible. But it also opens doors for creative solutions that could help you prosper as the economy recovers.

"Risk comes from not knowing what you're doing."

[Warren Buffett](#)

I will talk about what recession means to an average Canadian and how you can mitigate the risk and make the most of this crisis.

## How recessions affect an average household

An average family achieves financial stability when regular income is sufficient to pay bills and manage debt. This stability converts into financial well-being when the family has more money left after paying for essentials. How you use this money determines your financial flexibility. In a growing economy, your income grows, and you have more disposable income to spend on discretionary items.

But when economic growth stagnates, probably due to demand shock or supply shock, like an oil price hike, your income stagnates. I won't dive into the details as to why the economy is heading towards a recession. But it is highly likely that the United States is close to recession, and Canada will feel the pinch, too.

In a recession, prices of daily use goods and services rise to levels where they become unaffordable to lower-income households. These prices rise faster than income, which reduces the money left for discretionary spending. Households cut costs by spending less, reducing overall demand. This affects the revenue of companies that make and sell these discretionary items. Hence, these companies cut costs to survive, increasing unemployment. This adds to the troubles of households that are having difficulty meeting their expenses.

## How to withstand recession: An illustration

Let's understand recession with the help of an illustration. John works at a toy factory. The reduced demand for toys forced the company to slow production, reducing John's family income. Luckily, he was prepared for a crisis-like situation with savings, debt, and investments.

John had saved up eight months of his monthly salary for emergencies. This gives him eight to 10 months of buffer time to find another source of income, because finding a job is difficult in a recession.

When the central bank increased interest rates for the first time in March, John immediately paid off his credit card bill and personal loan and locked the interest rate on his mortgage. When funds are low, paying debt installments is the most cumbersome. You prioritize utilities and food over debt, leading to a high risk of default in a recession.

John invested \$5,000 annually in his Tax-Free Savings Account (TFSA) for a decade. He invested 60%, or \$3,000, in dividend stocks like **Enbridge** ([TSX:ENB](#))([NYSE:ENB](#)) and **BCE** ([TSX:BCE](#))([NYSE:BCE](#)). Now, he earns over \$1,800 a year in dividend income. He uses dividend money and \$1,000 of his TFSA investment to buy [value stocks](#) that are cheap in a recession. Over the decade, his value stocks doubled his portfolio, even in a market selloff.

## Investing in the current market

John has sufficient savings to withstand a recession. He plans to use his \$5,000 TFSA annual investment to buy value stocks in the current downturn. This is a ripe time to buy **Descartes Systems** ([TSX:DSG](#))([NASDAQ:DSGX](#)). The stock fell more than 30% from its November 2021 high in the tech stock selloff. Last week, the stock jumped 10%, as it moved from being close to oversold to being close to overbought.

The company supplies software solutions for the supply chain management. Companies whose operations depend a lot on the supply chain opt for these solutions, as it makes the whole process efficient and cost effective. These are two golden words for any company preparing to withstand a recession.

The global supply chain disruption from the Russia-Ukraine war did not slow Descartes's first-quarter revenue. As companies build an alternative supply chain, Descartes's revenue could accelerate, and the stock could make a new high. Even if the stock reaches its 52-week high of \$115, it is a 35% rally from the current price.

### CATEGORY

1. Investing
2. Stocks for Beginners

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1. NASDAQ:DSGX (Descartes Systems Group)
2. NYSE:BCE (BCE Inc.)
3. NYSE:ENB (Enbridge Inc.)
4. TSX:BCE (BCE Inc.)
5. TSX:DSG (The Descartes Systems Group Inc)
6. TSX:ENB (Enbridge Inc.)

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