

## September 14, 2006 – The Business Cycle

Booms, busts, expansions, contractions and the investment roller coaster that accompanies these changes to our economy offer many challenges when investing for retirement. The last 200 years of economic history show a consistent pattern of expansion and recession that is known as the “business cycle.” The business cycle generally lasts four years from peak to peak. It is often referred to as the “Presidential Cycle.”

The three asset classes we invest in are stocks, bonds and commodities. There is a sequence to the business cycle where the bull\* and bear\* markets for stocks, bonds and commodities continually rotate. These three markets each have a peak and a trough. So it follows, there are six distinct turning points or stages to the business cycle. The performance of each asset class is heavily influenced by the business cycle.

Each stage has specific characteristics that can be thought of in the same type of context as the four seasons in a calendar year: spring, summer, fall and winter. Each season has different activities that are suitable for the weather: like gardening in the spring and skiing in the winter. The six stages of the business cycle also offer different characteristics that tend to favor investment in one asset class over another.

Let’s look at each stage of the cycle and identify how each asset class tends to perform:

**Stage I:** economy is in recession; **bonds bullish, stocks & commodities bearish.**

**Stage II:** interest rates are falling; **bonds & stocks bullish; commodities bearish.** Note: the 1<sup>st</sup> – 3<sup>rd</sup> cut in the Fed Funds rate following an equity bear market has almost always given a reliable buy signal for equities.

**Stage III:** economy is in expansion; **bonds, stocks & commodities all bullish.** This is generally the best time to invest in growth stocks with less fear of downside risk.

**Stage IV:** interest rates begin to rise; **stocks & commodities bullish; bonds bearish.**

**Stage V:** inflation usually accelerates and commodities usually pick up considerable momentum; **commodities bullish; stocks & bonds bearish.**

**Stage VI:** when recessions begin; **bonds, stocks & commodities all bearish.** Cash is king.

It is often difficult to identify what stage the economy is in until some time after the stage has already begun. Avoid taking undue risk when conditions are confusing or unclear. When you are confident the indicators are giving you clear signals as to the current stage of the business cycle, a more aggressive investment approach may be appropriate.

Managing risk and diversification are extremely valuable in improving investment performance. It is my assessment, a more important task, is to correctly identify the current stage of the business cycle and take suitable action regarding asset allocation.\*\*

What stage are we in today?

Dave

\* Bull means the market is trending up. Bear means the market is trending down. \*\* Past performance is no indication of future results

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