

BEATING THE BUSINESS CYCLE

How to Predict and Profit from Turning Points in the Economy

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MAIN IDEA

In light of the longest bull run in history which lasted for most of the 1990s, many people now assume the business cycle has been mastered, and there is no need to worry about economic recessions or recoveries any more. This point-of-view, however, might be overly optimistic. The economy will continue to rise and fall in the future, and those who accurately forecast future these future turning points will have the greatest opportunity to position themselves advantageously.

“Since 1790, the U.S. economy has experienced forty-six business cycles. Time and again people came to believe that business cycles had been banished, only to be surprised by a new recession. No sooner had Mark Twain written about the ‘Gilded Age’ in 1873 than a depression enveloped the economy. In the twentieth century alone, we’ve seen three periods hailed as ‘New Eras’. As remarkable as it may seem, every so often we fall into the trap of believing that some new innovation, technology, or policy has paved the way for a New Era of endless prosperity, where risk and downturns are a thing of the past. It is from these heights of certainty that we tend to crash to the depths of despair, where risk seems to lurk around every corner. Neither extreme is realistic. Cycles always turn: the questions is when. While every cycle need not exhibit a spectacular boom or bust, it is a sure bet that you will see more recessions and recoveries in the future. Whether a mild recession or a major depression lies ahead, you can be forewarned and forearmed, protecting your interests by staying ahead of the crowd.”

– Lakshman Achuthan and Anirvan Banerji

To use the ebbs and flows of the general business cycle advantageously:

- *Learn how and why the economy expands or contracts.*
If you understand what contributes to the growth or contraction of the broader economy, then you’ll be more finely attuned to taking notice of business developments which will impact on the economy as a whole.
- *Get familiar with the leading indicators of the economy.*
These are the various indexes which will signify when a turning point of the economy has been reached. There are a large variety of publicly available indexes which can and should be used. Learn how to harness these to good effect.
- *Develop an “economic dashboard” – your own early warning device for turning points in the economy.*
Actively track what’s happening in the economy and where it’s headed next. As the cliché goes, to be forewarned is to be forearmed with everything you’ll need to act intelligently.

“Like it or not, our assessment of the future is colored by emotion. Subjective interpretations are driven by both the recent past and the prevailing wisdom, and will always lag at economic turning points. When the next recession hits, most people, oblivious of the turn in the cycle, will make the same mistakes as before. In the same way, we may fail to take advantage of the next boom in the economy. To break from this pattern of basing economic decisions on the recent past, you need to use a decision-making framework that can see through the delusions of the crowd, and anticipate the next turn in the economy. Good judgements are easy to make after the fact. But it is difficult to make the right decision in the heat of the moment. When it comes to gathering information for making decisions, most of us rely on sources that reflect the consensus view. Yet the consensus has a dismal record of spotting turns in the road ahead. Prevailing wisdom on the economy is delivered to you by the news media, whose ratings depend on the excitement that extreme views generate. Politicians and business leaders with their own agendas contribute to the hype. As with most things in life, ultimately you need to watch out for yourself.”

– Lakshman Achuthan and Anirvan Banerji

1. A Primer on Business Cycles Pages 2 - 3

The demise of the business cycle has been touted at various times in history, but it keeps on resurfacing again and again. A more realistic perspective, therefore, is to view the business cycle as an inevitable part of the operation of a free-market economy. Instead of banishing the business cycle from your planning, it makes better sense to try and understand it better. Integrate a cyclical perspective into your own business planning and be particularly wary whenever the popular consensus is that the current economic conditions will last indefinitely. Whenever those circumstances have occurred in the past, that has been the exact moment the business cycle moves in the opposite direction. Anticipate that trend will happen again and again in the future.

2. Leading Indicators for the Business Cycle Pages 4 - 5

The key to seeing through the fog and accurately forecasting the immediate economic conditions is to identify and track the right leading indicators. Significantly, leading indicators are important around the turning points of the economy, when most people will be forecasting a continuation of existing financial conditions. A good leading indicator will point which direction the economy is heading so you can make astute decisions which will take advantage of those economic conditions better than your competitors.

3. Build Your Own Economic Dashboard Pages 6 - 8

It is now possible to use the work economists do to develop a sophisticated “dashboard” which measures the overall state of the economy. As in an automobile or a jetliner, the dashboard allows the user to independently assess the course of the economy in an unbiased way. Some businesses need a very detailed dashboard which is fine-tuned to reflect impending turns of the economy as soon as possible, but the vast majority of businesses won’t need to go into such detail. For most people, all that will be required will be to develop an economic dashboard which has one or two key gauges to point the direction of the economy in the immediate future.

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