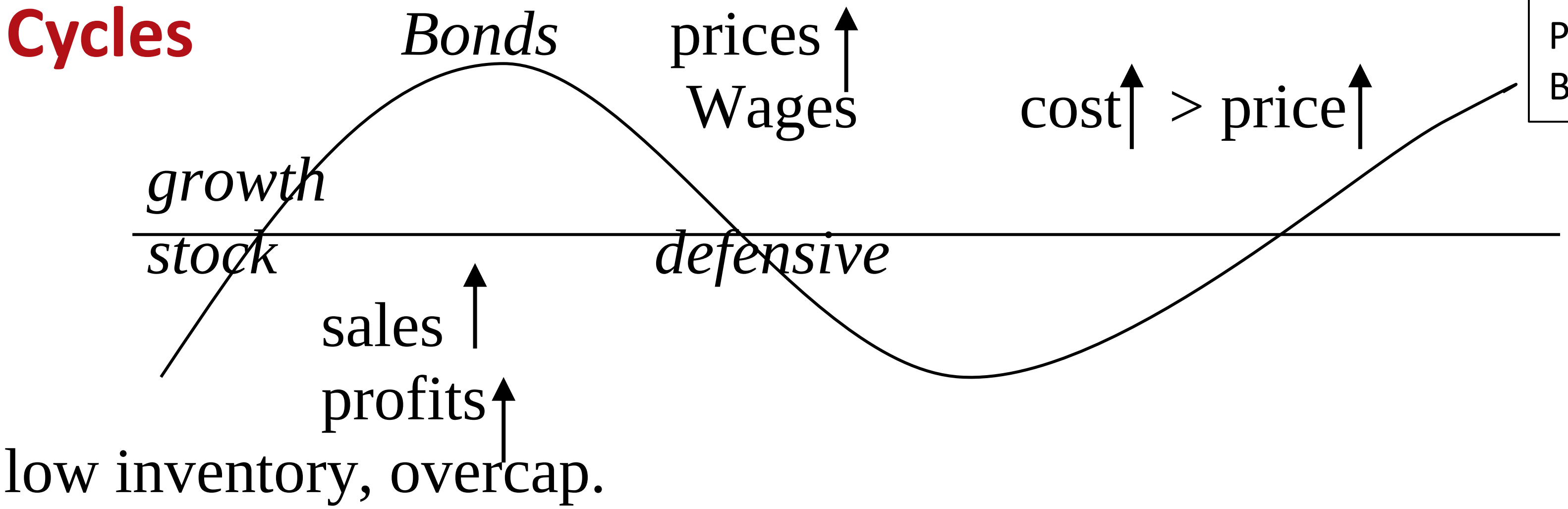
Business Cycles



- Seven years of plenty and seven years of lean!
- Its death has been proclaimed several times, most recently in the late 1990's. (post WW-II boom caused the Commerce department to rename the Business Cycle Digest to the Business Conditions digest)
- Has been more subdued in the last 20 years (10% of the time in recessions versus 40% of the time in the previous 90 years due to a) decreasing variability of output: agriculture => manufacture => services. b) inventory control, c) globalization, d) better monetary and fiscal control, e) financial and banking deregulation.

Why cyclical downturns even if periodicity not predictable?

- Exogenous (rising oil prices in 9 out of last 10 post-war, 9-11).
- Animal spirits (Keynes, insufficient demand, market failure as business investment swings from optimism to pessimism, jobs and incomes fall amplifying the above, unemployment rises, need government).
- Excessive supply, overinvestment, mismatch with savings.
- Policy mistakes (Fed actions first allow economies to overheat and then apply the brakes too hard).

Macroeconomic Indicators (NBER).

- Leading, lagged and coincident. Common convention that GDP decreases in 2 consecutive quarter implies recession! Recently dated as 2 quarters of 2001.

- Generally, leading indicators appear to increase 3-4 months prior to a recovery and decrease 7-8 months prior to a downturn. Sceptics claim 'stock prices forecast 9 of the last 5 recessions.'

- Diffusion indexes focus on the number of indicators that are up (or down) rather than the magnitude.

INDICATORS FROM FINANCIAL MARKETS.

Cash as a % of asset for US equity mutual funds

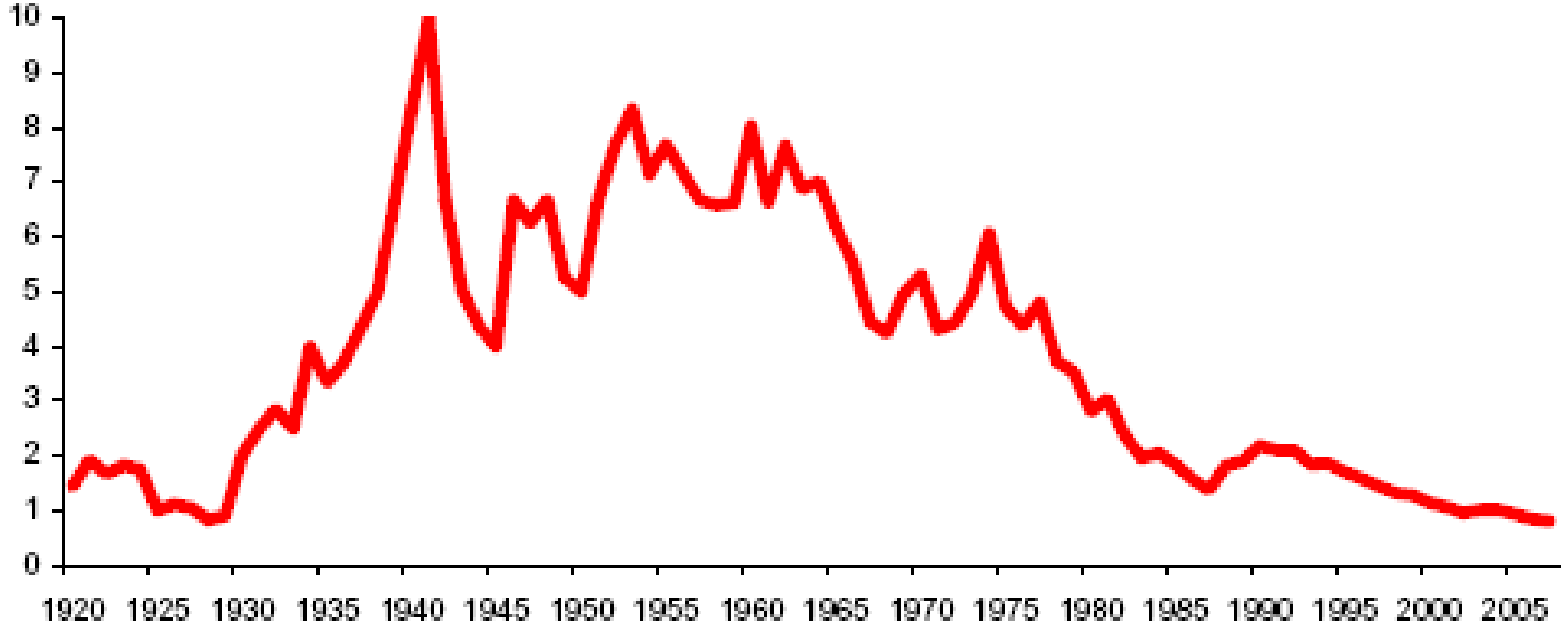
Source: SG Equity Research

Mutual funds pool money from investors to invest in securities and are managed by a fund manager.

PEOPLE HAVE BEEN BUYING STOCKS!

INDICATORS FROM FINANCIAL MARKETS.

The average holding period for a stock on the NYSE is now only 9 months! (years)



Source: SG Equity Research

BUT HOW LONG ARE THEY HOLDING THEM?

VALUATION CHARTS FROM FINANCIAL MARKETS.

Introduction to Investments
Prof S G Badrinath
Business Cycles and Indicators

Simple trailing 12-month PE on developed and emerging markets

Source: SG Equity Research

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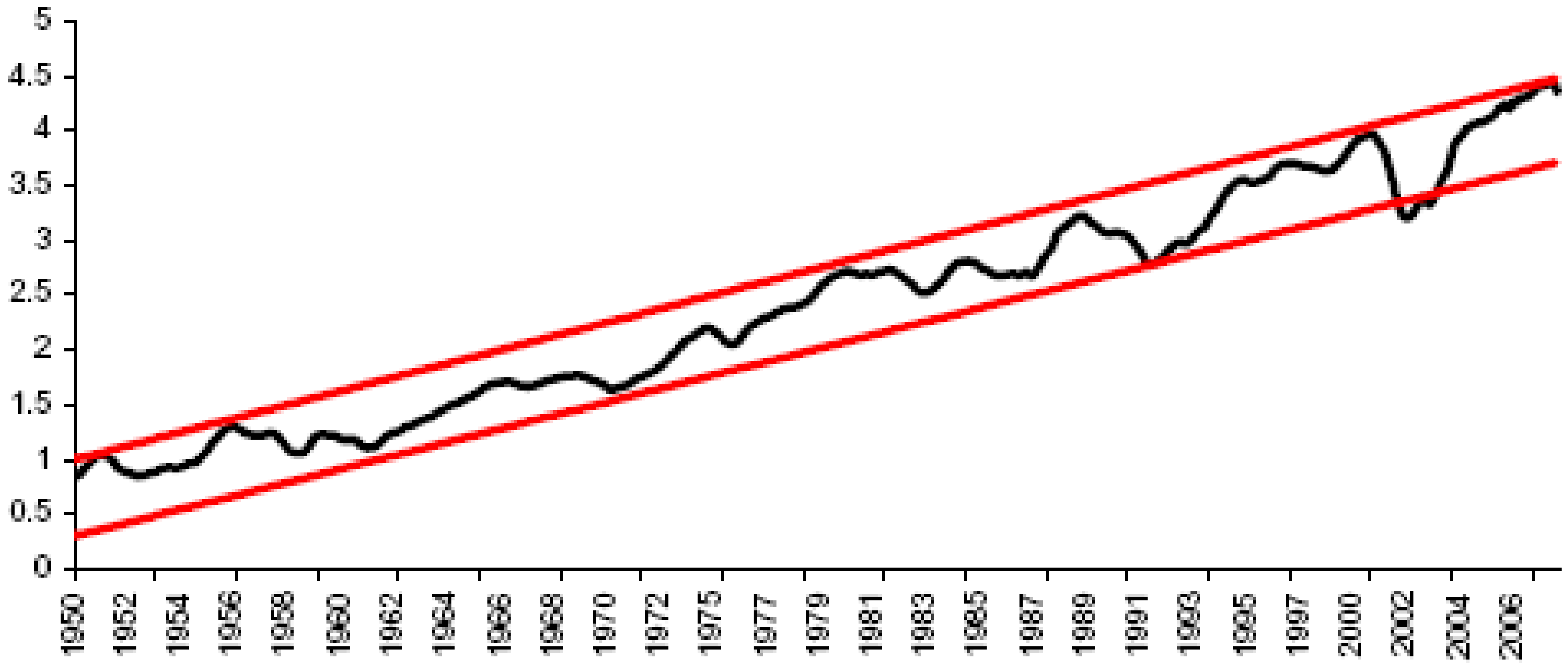
S&P500 log nominal earnings and 6% growth channels



Source: SG Equity Research

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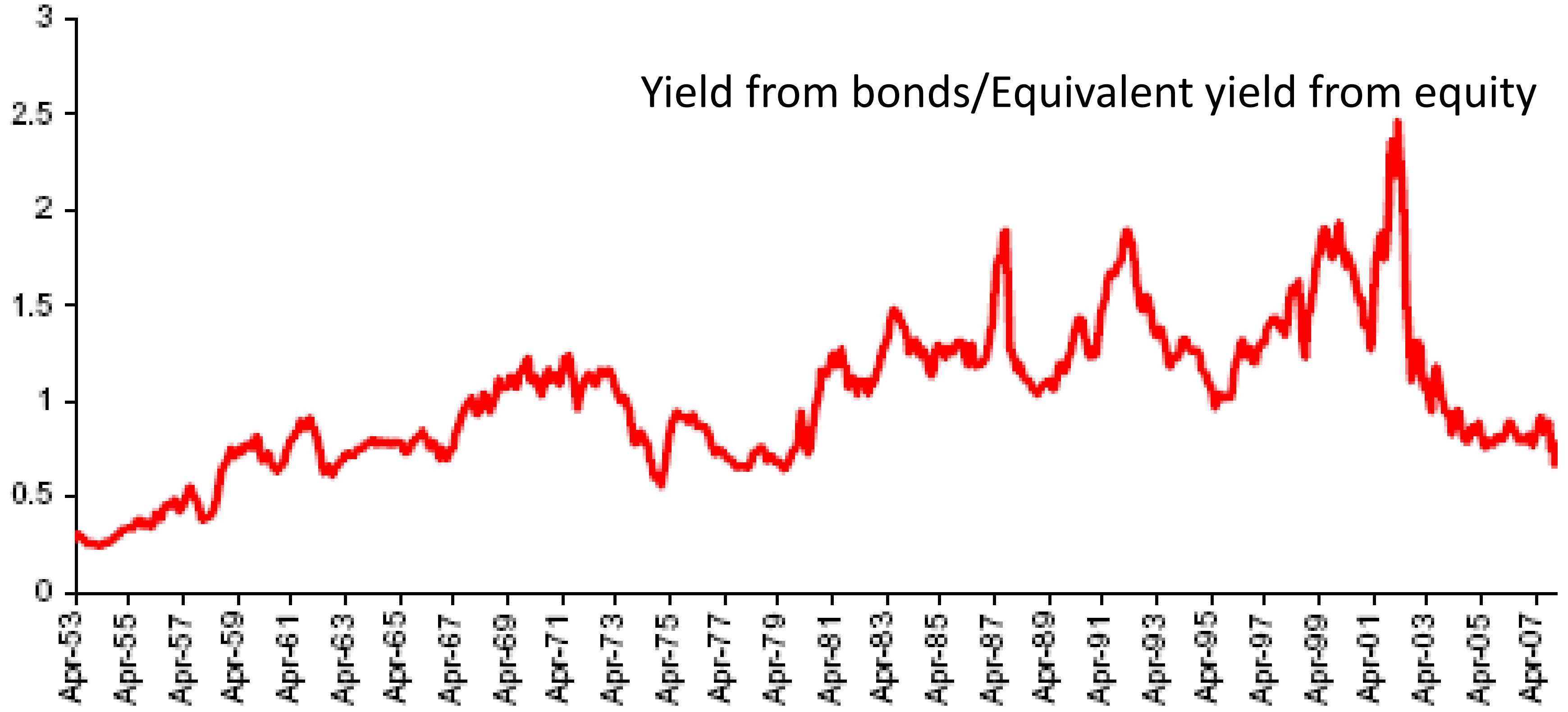
VALUATION CHARTS FROM FINANCIAL MARKETS.

Bond equity earnings yield ratio (US)



Source: SG Equity Research

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