

Riding the economic cycle

Every market downturn is different, but studying past cycles may give investors some clues what to expect this time around - and what action to take

Recent events in world economies and stock markets may seem extraordinary but they may still follow a pattern that has been repeated many times in the past.

By understanding this pattern, it is easier to put current events in context and get an overview of the most appropriate investment strategy.

Knowing the economic cycle

At any time, an economy is either expanding or contracting. Economic cycles have four phases: recovery, boom, slowdown and recession. These phases have clear characteristics - and certain asset classes tend to do well or poorly at different stages, - as the diagram shows below.

Duration of the cycle

A full economic cycle can take years. Recent economic cycles, however, have been characterised by long periods of recovery and boom followed by brief, but dramatic, periods of decline.

Typically, these cycles have lasted about ten years: a five to seven-year period of growth followed by a crisis and then a recession lasting two to three years.

Whether the current cycle will follow this timescale remains to be seen. However it is reassuring to know that all periods of decline have been succeeded by recovery - eventually.

What history has taught us

- **Act early:** Stock market cycles tend to be three to nine months ahead of economic cycles. So if economic recovery is expected in a year's time, it may be reflected in share prices in just three months.
- **It pays to stay invested:** the biggest one-day rises in the stock market have often happened right after some of the biggest one-day falls. Investors who are 'out of the market' can easily miss the beginning of the recovery.
- **Asset allocation counts:** Different industries and assets do well at different stages of the cycle. Investors who diversify across different equities, bonds and cash and other assets, may achieve the best balance of risk and return over the long term.

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Four stages of the Economic Cycle

* = sector that tends to do well

