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# EVALUATING MARKET PERFORMANCE OVER MULTIPLE BUSINESS CYCLES

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# Evaluating Market Performance Over Multiple Business Cycles

Article

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Online services have put the world at our fingertips. Swamped by so much information, it is inevitable that some of us will be swayed quickly and easily by inauthentic sources and voices. Not surprisingly, a large number of the most persistent of these sources are 'financial gurus' offering to make you rich – and, more often than not, instantly rich. What the genuine expert will tell us, however, is that there are no 'secret shortcuts' to riches.

Quite simply, if we want money, we must learn how to get it. In the stock market, that learning begins by studying the market.

Of the many things to study about the market, a good starting point is to examine how the market performs in various business cycles. At the basic level, market performance refers to how a security behaves in the marketplace. Securities, such as stocks and bonds, behave differently at different times as the market moves through the different periods that make up a business cycle.

## Business Cycles

The business cycle is the cyclical rise and fall in GDP (Gross Domestic Product), coupled with other macroeconomic variables like the employment rate, inflation and interest rates. In this market context, the business cycle is also known as the economic or trade cycle.

A business cycle comprises four stages – recovery, peak, recession and trough – which run and rerun in a cycle. A cycle's duration might be anywhere from two to twelve years although most cycles average around six years.

For the investor, identifying which stage of the business cycle the market is now in requires looking at various economic data elements. One such data element is labour market statistics.

For example, according to recent news reports quoting Bank Negara Malaysia's assistant governor Marzunisham Omar, the labour market is expected to weaken. The unemployment rate is expected to rise to 4%, compared to 3.7% during the global financial crisis.

So, where does our knowledge of that data element lead us? Does that information about labour trends indicate the market's current position in the business cycle?

Let's find out.

The table below is an overview of conditions within the four stages.

| Stages | Recovery | Peak | Recession | Trough |
|---|---|---|---|---|
| Inflation | Stable | Rising | Falling | Falling |
| Business | Growing | Slowing | Slowing | Gloomy |
| Employment | High | High | Medium | Low |
| Market | Booming | Weakening | Weak | Weak |

## Recovery

The recovery stage is a time for expansion too. Business is seen to be growing and profits are good. The unemployment rate has dropped and, as more and more people find jobs, consumer spending increases. The recovering credit market is adding money and liquidity to the market that has emerged from the worst phase.

The overall economic outlook shows improvement and the stock market is now booming. The sectors or industries look out for will be consumer and financial. This is also a good time to check the bond prices as, generally, interest rates are low.

As the market starts to move from recovery stage to peak stage and interest rates drop to their lowest, investors should also actively explore other segments like industrials, information technology and basic materials.

## Peak

In the peak stage, with the economy going full throttle and operating at full (or almost full) capacity, inflation increases quickly from labour or goods shortages.

As competition among businesses heats up, profits begin to slide down. Interest rates start to go up and the stock market begins to weaken. Before the market falls into the recession stage, investors should consider sectors like healthcare, utilities, energy and consumer necessities.

## Recession

In the recession stage, economic activity such as buying, selling, production and employment slows down. Unemployment starts to go up and consumer spending drops.

The overall outlook begins to turn gloomy and the stock market performs weakly. Interest rates are peaking. At this time, the best sectors to look out for are similar to those in the peak stage.

## Trough

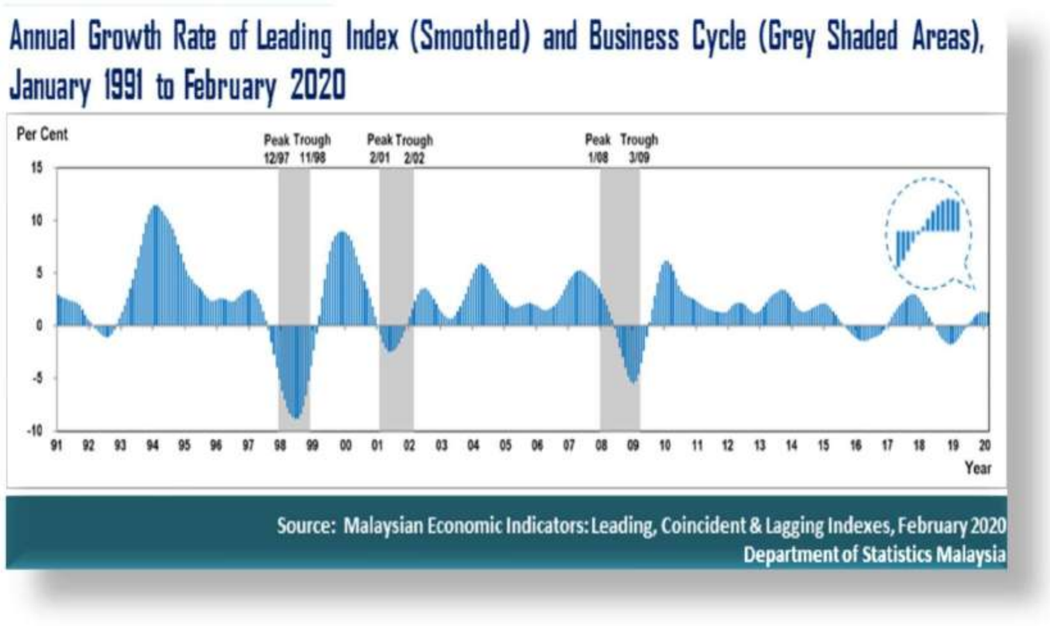
The trough stage hits the economy hard and the overall business outlook has changed from gloomy to severely pessimistic.

Unemployment scores at this stage and is at its highest among all the stages. With much fewer people gainfully employed, consumer spending falls to its lowest, triggering a fall in inflation.

The trough is the stage that precedes the recovery stage. Its typical indicators include a weak stock market, struggling businesses, declining sales and very low credit availability.

## Malaysia’s Business Cycles

The graph below, from the Department of Statistics Malaysia, spans a little over 29 years from the beginning of 1991 to the early part of 2020.




The graphical overview shows that Malaysia has passed through three business cycles (highlighted in grey) of varied durations.

The first recession stage was in 1997, denoting the Asian Financial Crisis which wrecked many economies in East Asia and Southeast Asia.

The second recession that affected Malaysia was in 2001. This resulted from the slowdown of the US economy and the reduced demand for electronics globally, thus substantially affecting Malaysia's manufacturing sector and the electronics industry.

The last recession was in 2008 when The Great Recession, a by-product of the US subprime mortgage crisis of 2006, affected all countries across the world. Fortunately, the Malaysian banking system had been building its foundations strongly and was ready to face and weather the erupting global financial crisis. However, the recessive impact was strongly felt in the external trade-related sectors.

## What Should We Do?

Researching the market can be a daunting experience. But if we are seeking good returns from the market, it is necessary to research it by looking into historical data and events and by observing the volatility of the market.

As investors, it is critical for us to clearly understand where we place our money. To begin relating to how you can reap the benefits of studying the market, start with what you have in your investment portfolio. If you do not know what and how your investment portfolio is, retrieve all your past investment statements, or check with your broker. Then list down existing assets, research the markets or indexes that you have invested in and take notes on how they have performed in the past. In any case, it is always good to talk to your brokers and gain some insights from them. They might also direct you to the right platform to learn more about the market.

After you have gone through your investment portfolio, look into the assets that have been allocated and see if there are any gains or losses for each asset. Check whether your portfolio is on par with your financial goals. If it is not, calculate the gap and estimate if you can earn back the ‘gap’ in your stipulated timeframe.

As you have read, different sectors react differently at each stage. It is important to frequently review your investment portfolio to ensure that you are riding on the waves of advantage. Like with different sectors, different asset classes too will perform differently at each stage. Therefore, it is best to diversify the investment portfolio to manage the market risk.

Diving into the market news pool is a good first step into the world of analysis. Search for reliable websites and establishments to start your learning journey.

You could also attend talks and events (online webinars in these lockdown times) and you will be surprised to find that it isn’t hard to understand the market. But, yes, it takes hard work!

Online platforms like Bank Negara Malaysia or Bursa Malaysia are trustworthy sources for gaining knowledge of the market. Overall, keep calm and always trust the process. It is crucial to take a step back and look at the bigger picture. Do not blindly throw in your money. Learning how to read the market during every stage in the business cycle could help you be on your way to a sweet investment success.