

Current position of the business and financial cycle

(As of March 2003)

The markets are forcing the hand of policy makers. As usual, they are pushing the policy makers to act. The markets, not surprisingly, always win. Why? Because the business cycle keeps moving relentlessly through its phases, as day follows night.

Phase 1. Following 12-24 months of business growth, inflation, commodities, and bond yields move higher. Because of rising inflation, consumers' income slows down. Sales, as a result, start growing at a slower pace. Because of rising costs, business becomes more cautious. Hiring and new investment are reduced. The money supply slows down as business borrows less. **Liquidity shrinks.** The stock market declines. The dollar peaks.

Phase 2. After 12-24 months of slower growth in liquidity, business activity weakens as inventories keep accumulating. Commodities, inflation and bond yields continue to rise. Stocks and the dollar remain weak.

Phase 3. Following 6-12 months of slower growth in the economy, commodities, inflation and bond yields decline. Stocks and the dollar are not declining as rapidly as in Phase 1 and Phase 2.

Phase 4. Business begins to borrow following 3-6 months of lower interest rates, commodities, and inflation. Reason: margins improve as costs decline. Consumers' income after inflation improves. Sales stabilize and start rising faster. **Liquidity in the system improves.** The stock market and the dollar bottom.

Phase 5. After 12-24 months of growing liquidity, business activity begins to improve. Commodities, inflation, and bond yields continue to decline and eventually stabilize. The stock market and the dollar continue to rise. **Go to Phase 1.**

Which is the current phase of the business cycle?

Phase 1 began in early 2002. Now we are close to the beginning of Phase 3: The economy has been slowing down, as we expected last year. The next important turning points will be the top in commodities (now under way) and inflation, which should take place in the next few months.

Please read *The Peter Dag Portfolio Strategy and Management* (updated twice a month on this website www.peterdag.com) for a more detailed analysis of the most current business and financial cycle developments. You will also find specific investment strategies and recommendations to take advantage of emerging developments.

We would also suggest you read Dr. George Dagnino's book *Profiting in Bull or Bear Markets* (McGraw-Hill).