STOCK MARKET PHASES

In phase 1 of a financial cycle liquidity accelerates, accompanied by a strong stock market. Meanwhile the economy grows slowly as commodities and interest rates decline. It is quite typical for the dollar to strengthen and for the yield curve to steepen during such times.

In phase 2 the economy begins to pick up its pace and grows more rapidly. Commodities and interest rates bottom as monetary aggregates expand. The dollar remains firm and the yield curve stops steepening. The stock market is strong and reaches overvalued levels.

In phase 3 the growth of the monetary aggregates peaks and declines while the economy remains strong. Interest rates and commodities rise as the dollar sputters. Stocks begin to act poorly, and the market becomes very selective and value oriented. The yield curve begins to flatten.

In phase 4 the protracted decline in liquidity and the rise in short-term interest rates cause the economy to slow down quite visibly. Interest rates peak. The dollar remains weak. The yield curve is now flat or inverted. Stocks reach a fairly valued level.

Phase 4 sets the stage for phase 1 and the beginning of a new bull market.

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