THE INVENTORY CYCLE AND

YOUR INVESTMENTS

1. **The Fed** allows liquidity to grow more rapidly to meet increasing credit demand.
2. The increase in liquidity positively impacts **stock prices**.
3. Because of the increased liquidity, consumers buy more goods and services. **Sales** improve.
4. Because of stronger sales, manufacturing increases **production** to build up **inventories** to meet sales.
5. In order to increase inventories, business has to borrow short-term to finance the production of inventories.
6. The outcome is higher **short-term interest rates** due to higher demand for money.
7. The rise in short-term interest rates eventually discourages **consumers** from making further purchases.
8. **Sales** slow down and business **borrows** less as the outlook becomes more uncertain.
9. **Liquidity**, which measures credit expansion, begins to decline.
10. **The stock market** sputters due to slower growth in liquidity and rising short-term interest rates.
11. Eventually business recognizes **inventories** are rising too rapidly relative to sales
12. **Production** is cut to reduce inventories. Eventually inventories decline in line with sales.
13. Short-term **borrowing** to finance inventories declines, and the slower demand for money places downward pressure on short-term interest rates.
14. Eventually the decline in **short-term interest rates** encourages business and consumers to **borrow** and spend more aggressively.
15. **The Fed** lets the money supply accelerate to match the higher demand for credit.
16. **Stock prices** respond favorably as short-term interest rates decline and liquidity grows more rapidly.