Understanding business cycles and their impact on asset classes

It is best to maintain awareness of what is happening in the business environment and continually review your portfolio on a periodic basis. IMAGE: PIXABAY

Continued from previous page

Inflation rate starts to retreat, corporate profits decline and credit market dries up. Central banks start to adopt an accommodative monetary policy, and as corporate inventories start to reduce, this sets up the path for a recovery.

Recovery (key outcome – early expansion)
With the aid of accommodating monetary and fiscal policies, lower prices and rising production, Gross domestic product (GDP) starts to stabilise. Though unemployment rates may still be high, layoffs start to slow down. This brings a dramatic change in the spending pattern which is most pronounced in housing and durable goods. Inflation remains moderate and continues to fall. This also marks the inflection point with momentum moving from negative economic activity to positive. Credit conditions stop tightening amid easy monetary policy, creating an environment for margin expansion and profit growth. This marks one of the best periods of economic growth.

Expansion (key outcome – late expansion)
During this phase, which is typically the longest phase of a business cycle, economic activity shows continued acceleration. Unemployment rate starts to fall as corporations resort to increased rehiring with possible wage increase.

Consumer spending starts becoming more broad-based. Inflation continues to be modest, keeping a healthy margin for corporates. Corporates reinvest their profits into expansion which helps the equipment manufacturers and construction sector.

Credit growth becomes stronger as a reflection of strong profitability further helping expansion and improved sales.

Different asset classes tend to behave differently in each of the phases of business cycle.

How do we know which cycle are we in?
There are a few questions we can ask to assess which phase of the business cycle we are in:

- Are corporate earnings growing or decreasing?
- Is the GDP growth rate increasing or slowing down?
- Are businesses expanding or contracting?
- Is inflation moving up or down?
- Are central bank monetary policies accommodative or restrictive?

What are my next steps?
It is important to note that different countries may be in different phases of business cycle. Also, there is never a clear demarcation of the changes in the phases of the business cycle and often these transition periods are blurred.

It is best to maintain awareness of what is happening in the business environment and continually review your portfolio on a periodic basis to assess any impact or actions based on changes in the business cycle apart from your own personal circumstance.

As evident, different asset classes perform differently during various phases of business cycles, it is good to follow a strategy of diversification across multiple asset classes, to help manage the market risk through these phases of business cycles by not being over-concentrated in any one particular asset class. It is always good to have a long term perspective while taking investment decisions and avoid short term market noise or emotional decisions. Seek professional guidance where possible.

Disclaimer: This article is intended for educational purposes only and does not constitute investment advice or any recommendation. Views expressed are of the author alone and do not represent any organisation.

☛ Deepak Khanna, CFA, is the Head of Wealth Development with HSBC Bank (Singapore) Ltd

GOLD REPORT

By Benjamin Lu

Gold retreats over renewed global risk appetites

A weekly market summary for gold, Sept 2-6

GOLD prices pared back early gains over an improvement in global risk sentiments. A resumption in high level trade talks between the world’s two largest economies (the US and China), along with softer geopolitical overtones (Hong Kong, Brexit), eased risk-off sentiments for the current term.

Better-than-expected Caixin PMIs (China) and strong US labour markets spurred risk- assets forward while imposing considerable headwinds on the precious metal. Heightened US-China trade optimism and buoyant market sentiments will impose considerable headwinds on the non-interest bearing asset amid profit-booking activities by money managers.

What should investors look out for in the longer term?
The next FOMC meeting (Sept 18) will be of key focus as market expectations build for an additional quarter-point cut in US interest rates. Financial traders have maintained bets for a reduction in US borrowing costs amid subdued US inflation levels and lacklustre manufacturing activities. Safe haven assets, though easing up on bullish gains from softer geopolitical overtones, will remain supported over rising economic uncertainties (2H 2019). Accommodative monetary policy along with looming global recessionary concerns will keep investors vested within safe haven assets for the current term.

Technical Analysis for Spot Gold (XAUUSD)
The precious metal pulled back from freshly minted 2019 highs (US$1,555.00) as gold bulls struggled with an extension of the bullish wave. Strong negative bias was triggered as spot gold failed to hold above the key technical level of US$1,535.00. Gold prices must break above US$1,535.00 for a continuation of the bullish trend scenario towards the next main station of US$1,555.00 (previous highs). Failure to hold above the key support level of US$1,516.00 will promulgate bearish bias towards the key trend line support of US$1,500.00 (Key Psychological Level) and US$1,492.00 for the near term.

Weekly Market Assessment: Range-Bound
Key Resistance Level (1): US$1,555.00
Key Resistance Level (2): US$1,535.00
Key Support Level (1): US$1,492.00
Key Support Level (2): US$1,480.00

☛ The writer is an investment analyst at Phillip Futures