

UNDERSTANDING BUSINESS CYCLES

What has upswings and downturns, troughs, peaks, and plateaus? Though such terms could easily describe a roller coaster ride, in fact they are commonly used to refer to something known as the business cycle.

The business cycle — also known as the economic cycle — refers to fluctuations in economic activity over several months or years. Tracking the cycle helps professionals make forecasts about the direction of the economy. The National Bureau of Economic Research makes official declarations about the economic cycle, based on factors such as the growth of the gross domestic product, household income, and employment rates.

RECOVERY AND RECESSION

An upswing, or recovery, occurs when the economic indicators improve over time. A recession occurs when the same indicators go through a contraction. A particularly long or severe recession is referred to as a depression.

Despite being called a cycle, it's important to understand that the business cycle is not regular. It doesn't happen at set intervals. Some recoveries have lasted several years while others are measured in months. Recessions, too, can last for a number of years or be as short as a few months.

MOVING IN WAVES

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STAGES OF CYCLE

So how should investors look at information about the business cycle?

Investors who understand that the economy moves through periods of recovery and recession may have a better perspective on the overall cycle. During recovery, understanding whether the economy is at an early or late stage of the cycle may influence certain investment decisions. Conversely, during a recession, deciphering whether the economy is passing through a shallow or deep cycle also may influence certain decisions.

Generally, the business cycle will transition from recovery to recession — and recession to recovery — over several months. Understanding that the economy travels through cycles may help you put current business conditions in better perspective.

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