

A Typical Recession Economically

ANATOMY OF A MARKET CYCLE...

At the height of a boom, property prices are rampant and company profits hit all-time record highs. Eventually, governments attempt to reign in the inflation that follows by putting up interest rates. This causes exchange rates to move, switching the balance of power between exports and imports and switching the cost base of large organizations. On the ground the consumer hurts with higher mortgage payments and they reduce their spending further. This impacts the top line of the corporation and creates a slump (August 2007) in the market.

Fund managers will see interest rates go up and predicatively assume a downturn is near. Share prices then start to fall and companies that are highly geared are unable to meet their financial commitments, putting many on the brink of their financial covenants with the banks. Corporate failures (September 2008) follow, resulting in widespread fear and panic in the marketplace. This leads to a slowdown in the economy as consumers and corporates alike energetically hold on to their cash.

This leads to a slowdown in the economy as consumers and corporates alike energetically hold on to their cash. This leads to a significant reduction in spending and production and commodity prices fall in line with demand. Newspaper reports will then show historical figures of recessionary times - meaning two successive quarters of negative growth - or, worst case scenario, depressionary times with four quarters of negative growth. The overall feeling in the market is one of complete gloom. Overseas reserves fall, money is completely tight and lending almost comes to a standstill. Property prices tumble and the economy hits rock bottom.

of "normal time". Overseas reserves in many countries haven't even dropped yet and governments are attempting to artificially drop interest rates to stimulate economies. Some countries in the world, however, have little to no margin left in their interest rate equation; it gets harder and harder to keep dropping interest rates to stimulate demand and the structural shifts in that economy will still need to occur before any long-term recovery begins. The lever being played with is time - if you bring in interest rate cuts early it theoretically will reduce the impact of the recession creating a buffer for the economy, but it may alternatively lengthen the time it takes to move through the recession.

- for example USD \$1.75 has fallen below \$1.50. As business owners, we ask ourselves a number of questions during this period:

- Do I buy or invest now?
- Are we at the low point?
- When is this?
- Do I buy in my own country or expand overseas?
- What will happen to exchange rates?
- The economic data of trends - how long do recessions last?
- What are the opportunities during a recession?
- How do I attract clients during a recession?
- How do I find recession-proof clients?

**“This recession is nothing more than a cycle!
The opportunity always lives in doing the opposite
to the market – buy low, sell high.”**

The safest place to have your money at this point is in bonds. Economically all of the inefficiencies have been purged out of the system and economies are back to their core. Minimal spending is being met by minimal production delivered as efficiently as possible. The recovery starts - interestingly at this time history shows that most governments will now drop interest rates, buoying on the recovery. This would normally lead to an increase in share prices as fund managers pre-empt a general recovery and with the increase in demand commodity prices will increase, overseas reserves will start to increase and healthy profits will return to the system. We are now back into full swing, money is now easy to get hold of and the increase in property prices is just around the corner.

How is this cycle different?

What's interesting about this cycle is that many governments around the world are attempting to preempt the cycle by reducing interest rates well ahead

Shifting interest rates alone does not remove the need of a recession to rid the inefficiencies in the economy.

Australia, conversely, by way of example of the Asia Pacific region, is in great shape with high interest rates. There is plenty of movement available, overseas reserves are huge and the government budget has a huge surplus. Generally speaking, the Asia-Pacific region should see themselves well through the next three years, with the IMF predicting that Australia will not even go into recession.

The latest round of exchange rate movements (of round numbers 30%) was prompted by the change in interest rates and the economic forecasts coming out of the USA. Interestingly as the USA heads into a deep recession its exchange rate moves positively against all other currencies. The markets assume that with demand down in the USA the economic cycle kicks in for all countries. Interestingly most exchange rates are now nearing their long-term averages or below

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