Get Rich Slowly - Blog

How to profit from economic cycles

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(Since April is Financial Literacy Month, a number of articles will be devoted to more educational topics. This is Part IV in a four-part series about how understanding economic cycles could inform your financial decisions. Part I is Understanding economic cycles: An introduction. Part II is Recognizing economic seasons: recovery and growth. Part III is The fall and winter seasons of the economic cycle.)

In the first three parts of this series, you saw how the economy moves in cycles of seven to 10 years, and how each cycle can be broken down into four phases which correspond closely to the seasons of nature. We also looked at some of the telltale signs of economic activity that can help us recognize where we are in the cycle.

You may be thinking, “That’s all interesting, but how can I apply that knowledge to my personal financial life?” Let’s start by decapitating the elephant in the room — market-timing. Market-timing is a fool’s game. However, most of the time market-timing refers to trying to find the high point in the market to sell high. It is true: Nobody is able to tell when a market has reached its peak.

The same people who advise us not to try to find a selling peak do ***not*** say the same thing about finding a low entry point. Warren Buffett, arguably the best investor, says he has stopped trying to time the market. However, he is quite vocal in every recession that buying low is a wonderful thing to do.

Many people who stay away from market-timing also seem to stay away from buying low as part of “that thing we don’t do.” Buying low in a recession is not included in the general advice of “let’s not try to time the market.”

Okay, now that market-timing is no longer lurking in the back of your head, let’s see where we *can* all apply this and potentially benefit from our view of the economy moving through its four seasons of every cycle.

How the seasons could apply to your job

Your employer is affected by the four seasons of the economy too. But since most employers are oblivious to the seasons, it is a good guess that your employer is likely to behave like Farmer Clod — i.e., your employer will probably do everything at the wrong time.

Government employers depend on tax revenues, so they also fall victim to businesses that act like Farmer Clod. So, whether you work for a business or government employer, chances are you are working for Farmer Clod. If you had any plans to start your own business, using this insight can propel you from a mom and pop to the market leader in a single cycle. (A good friend of mine did.) But that isn't our main concern here.

Your long-term job strategy

Now that you understand that your employer is probably a Clod (through ignorance more than malevolence), you can predict what they are going to do, and when.

Here is your employer's strategy:

- In winter, just survive
- In spring, just survive
- In summer, grow, grow grow
- In fall, grow, grow, grow

Armed with this knowledge, you can plan your long-term strategy. Your No. 1 goal in any job typically is to leave on your own terms (i.e., avoid being laid off or fired). Your No. 2 goal is to make as much as their system will allow. All the other goals of growth, promotion and self-actualization only kick in after that.

The first thing you do with this knowledge is to evaluate your employer. Ask yourself, "How well will they survive the next recession?" Your best clue is to figure out how they weathered the previous recession. What percentage of people did they lay off? Did they cut pay or hours? You get the picture. A job in a construction company is probably more vulnerable to recession than a job in a department of the federal government, for example.

Increasing your value

The second thing to understand is that your best bet for a promotion and/or a raise will be in the summer and fall. Don't be impatient when you get none of that in the winter and spring. Instead, use winter and spring to position yourself to be one of the prime candidates for said raises and promotions once they start coming.

What typically happens in the cutbacks of a recession is that every survivor gets loaded with more work. You have a choice: You can grumble and bear it, or you can see it as the perfect setup to position yourself for the next round of promotions and raises. The wider your experience, and the more you contribute to your employer's survival (which is their main agenda), the more likely you are to be promoted and/or to receive a raise.

If you are aware of the seasons and your employer's reactive strategy, you can jump on the summer and fall to get things like paid training, trips to industry networking events, things which enhance your value. It is a little like squirrels storing up acorns in the good times: You see them for the fleeting times they are and make hay while the sun shines. Your goal is to become as valuable as possible. Then, when the inevitable recession comes along, the more competent you are and the more flexible, the less likely you will be let go.

Knowing when to jump ship

My wife worked for a dot com company in California. When her department shrank from over 80 people to six, she was one of the six because she understood and supported management's goal to survive. She knew a lot about a lot, simply by helping people out and being flexible. In the end, when we decided to come to Colorado, she was hoping to be let go, in order to get a severance package, but they liked her so much that she had to resign — and even then they tried to keep her.

Last thing: Fall in the economy is when you may get the most enticing new job offers. Be careful, though: In the inevitable recession, the workers with the shortest tenure usually get the first pink slips. The best time to make a job change is late spring/early summer (in the economy, not in nature). That way you have a long time to build up your internal network and seniority.

Simply being aware of the seasons of the economic cycle and how they impact your employer may help you in many ways you never considered.

How the seasons could apply to your home

If you plan to own a home, understanding the cycles of the economy will help you pick your best entry point into the home market: a recession. The value of any given home you have your eye on will drop in a recession. Let's say you were considering a home today which is on the market for $300,000. Chances are that same home could be had for $250,000 if purchased in a recessionary period. (That's about the ratio we have observed in our neighborhood.) Waiting a few years to save $50,000 is a good thing in my book.

Trading up and down-sizing

Understanding the four cycles of the economy helps you not only with buying your first home, but also with how to navigate trading up or down. As we pointed out in "How not to approach rising home prices," many people get caught by a common delusion. When home prices go up in the summer and fall seasons of the economic cycle, and their home equity increases, they think of it as a permanent increase in their wealth. Then they do things like trade theirs for a bigger home, or borrow against that equity for one noble reason or another.

There is nothing intrinsically wrong with wanting to trade up, whether it is for logical reasons or because you simply want a nicer place. The big mistake is doing that in the summer or fall seasons of the economic cycle. The winter and spring seasons of the economic cycle are the best times to trade up. On the other hand, if you want to scale down (for example, if you are an empty-nester or for other reasons), the summer or fall seasons of the economic cycle are the best seasons to do that.

How the seasons could apply to your investments

This knowledge of the seasons of the economy can inform your investment decisions too. Let's look at a couple different investment vehicles and methods of investing.

Monthly investors

If you invest monthly, as part of a 401(k) or other retirement plan, then your best course of action is simply to continue doing that, regardless of the season. However, if you do have any flexibility, increasing the amount you invest in times of recession and early recovery will net you more in the long run. This runs counter to what most people want to do: In tough times, it is instinctive to want to hold on to your cash as much as possible. Now you know that recession is the winter investment sale that only comes around once every 10 years. The more money you have available to pounce on those bargains, the better off you will be in the long run. I call that "dry powder."

Rental property, art, and collectibles

If your investment vehicle of choice is rental property, you probably don't buy a property every month. However, your knowledge of the seasons of the economy can help you decide when to buy the next property. The fall season in the economic cycle is usually the worst season of all to purchase property, yet it is the season most properties get bought. I call it "the Farmer Clod syndrome."

It is much better to wait until the spring season of the economy, when tenants come back into the market and prices are still very low. If you had any plans to liquidate any of your properties, you know that fall is the proper time. A good friend of mine is a major real estate investor. Using this information, he sold a major shopping mall in the fall of the previous cycle. Major deals like that take a long time to close, but he told me he was extremely grateful for this knowledge of the seasons when that deal closed in August of 2008, the month before the big stock market crash.

Likewise, if you invest in things like art or collectibles, the time to buy is in the winter and spring seasons of the economic cycle, and fall is the time to sell.

Ignore the dominant emotions in every season

Every successful investor will tell you that your emotions are your biggest enemy.

- **In the winter and spring** seasons of the economy, fear is the dominant emotion. But that is precisely the time to be bold and move, planting like Farmer Fred.
- **In the summer**, the rising tide floats all boats. The dominant emotion then is to assume this will go on forever. Never presume upon the future in summer.
- **In fall**, the dominant emotion is optimism, enticing people to buy things, again at exactly the wrong time. As a general rule, fall is the season to sell, not to buy.

As a general rule, debt is bad. However, if you are going to incur debt, the winter and spring economic seasons are the only times to do it. I personally believe that the summer and fall seasons of the economy are good times to get rid of debt. But, more than that, I believe summer and fall are the times to build up the dry powder to scoop up the bargains you only get once every 10 years. An online savings account to hold your liquid assets could come in quite handy at such a time.

What we cannot control

The world we live in does not move on a straight line. Whether we like it or not, it ebbs and flows like the tide. The economy brings with it seasons of easy money and tough money. Anybody who thinks their wealth will accumulate in a straight line hasn't been through a recession yet. The reality is that there are times when growth is what we call "slim pickings" and there are other times when you just can't lose. Wisdom, I believe, lies in understanding that all four seasons have opportunities to grow wealth — however, those opportunities look and act differently.

We can benefit from all four of the seasons if we are prepared and flexible, as opposed to being dogmatic that there is only one way to get rich slowly. Perceptive readers may have noticed that J.D., after following the proper strategies to get rich slowly in the spring and summer of the previous cycle, was flexible enough to grasp the unique opportunity to harvest (sell) … in the fall of the economy.

Farmer Clod and Farmer Fred faced the same set of changing circumstances. Fred knew what was coming each time as well as how to benefit from each season. Clod simply reacted based on feelings ("nothing more than feelings," to quote the old song).

Everyone has a unique set of circumstances, history and challenges. There is no one-size-fits-all formula. You are going to achieve the best results for you by understanding what the economy gives and takes, and by figuring out strategies to take maximum advantage of each of the four seasons of the economic cycle.