

Beyond Market Noise: Applying Business Cycles for Smarter Investing

How Understanding Economic Phases and Credit Cycles Can Guide Your Portfolio

By Nico Tschanz, Head of Wealth Management at Dexbridge Capital

Dear Reader,

Amid ongoing market noise—such as tariff discussions, policy shifts, and global uncertainties—markets are buzzing with volatility. These daily fluctuations can overwhelm even seasoned investors. Yet, the economy follows predictable patterns known as business cycles, offering a steady guide through the noise. By grasping these phases and the linked credit cycles, you can make informed decisions on assets like stocks, bonds, real estate, and commodities. Let's explore how this timeless framework empowers your portfolio in turbulent times.

Understanding Business Cycles

Business cycles are recurring expansions and contractions in economic activity, affecting broad segments of the economy. These fluctuations arise from factors such as changes in population, technology, expectations, political developments, and policy decisions. Unlike predictable seasons, cycles vary in length—from more than one year to 10 or 12 years—but they follow a sequence of phases: recovery, expansion, slowdown, and contraction. Investors and analysts focus on these cycles because they influence expectations, business decisions, and household behaviors. For instance, during expansions, companies ramp up hiring and investment, while contractions lead to cutbacks. Credit cycles play a crucial role here, as they determine lending availability. When credit expands freely, it fuels growth in sectors like housing and construction; when it tightens, it can amplify downturns. This is evident in historical examples, like the 2008 global financial crisis, where credit peaks led to systemic banking issues and severe recessions. Understanding credit cycles helps investors anticipate policy moves, such as macroprudential measures to dampen booms, and assess recession risks if contraction phases align.

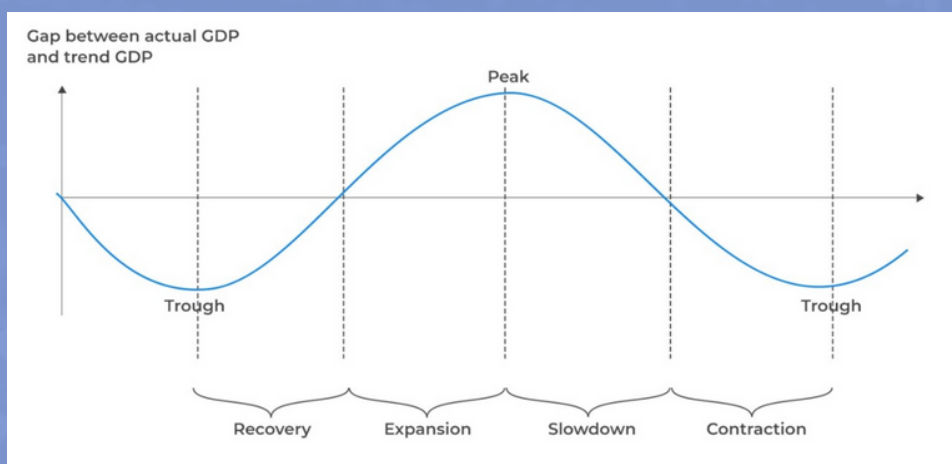
Four Phases of the Business Cycle

Each business cycle phase has distinct characteristics that guide asset performance and investor strategies. Here's a breakdown, drawing on typical patterns while keeping it straightforward:

- **Recovery (Trough):** The economy emerges from a downturn, with negative output gaps narrowing. Activity levels are below potential but start rising, unemployment remains high but begins falling, and inflation is moderate. Stocks often rebound as bargains emerge, while commodities like Brent oil stabilize with reviving demand. Bonds provide steady income, and real estate may see early opportunities as credit loosens. Example: Post-2008 recovery saw undervalued stocks surge.
- **Expansion (Peak Approach):** The economy enjoys positive output gaps, with above-average growth. Businesses hire overtime and permanent staff, unemployment drops, and inflation picks up modestly. Stocks thrive on rising earnings, real estate booms with easy credit (e.g., Dubai's current surge in off-plan transactions amid expanded freehold zones), and commodities like Brent rise with strong demand. Gold may lag as risk appetite grows. Behavioral trap: Over-optimism can lead to chasing peaks—stick to diversified growth assets.

- **Slowdown:** Growth decelerates, positive output gaps narrow. Activity measures slow, hiring continues but at a reduced pace, unemployment starts rising, and inflation accelerates further. Safe assets shine: Bonds offer higher yields as investors seek stability, gold gains as an inflation hedge. Stocks become volatile, real estate cools if credit tightens, and Brent may soften. Indicators to watch: Rising unemployment or decelerating GDP can signal this shift.
- **Contraction:** The economy weakens, potentially into recession, with negative output gaps opening. Activity falls below potential, businesses cut hours and jobs, unemployment rises sharply, and inflation decelerates (with a lag). Bonds and gold perform well as safe havens, stocks decline, commodities like Brent weaken, and real estate stagnates amid tight credit. Historical lesson: The 2020 COVID-19 recession showed how contractions, amplified by initial credit squeezes, hit global markets—favor utilities and government securities here.

Exhibit 1: Business Cycle Phase Characteristics



Source: CFA Institute, CFA Program Curriculum Level I, 2025

Market Conditions and Investor Behavior

Market conditions evolve with the cycle, influencing how investors behave and allocate assets. In expansion, optimism drives risk-taking: Lean into stocks for growth. Commodities like Brent benefit from demand too. At peaks or slowdowns, shift to bonds for yield and gold for protection against inflation or volatility. During contractions, fear often leads to panic-selling—a common trap that locks in losses. Instead, preserve capital with bonds and gold, eyeing trough bargains. Credit cycles amplify these: Loose credit boosts stocks and real estate; tight credit favors bonds and pushes investors toward stability. To navigate noise like tariff shifts, monitor key indicators: GDP growth, unemployment rates, inflation, and yield curves via financial news or your advisor. Historical cycles, like 2008, remind us: Those who followed phases diversified and recovered stronger.

Why This Matters Today

In an era of constant market noise, returning to economic fundamentals like business and credit cycles helps cut through the clutter. By focusing on long-term drivers—such as growth patterns, lending trends, and policy impacts—you can make decisions that stand the test of time. Sometimes, it's best to skip short-term distractions and zero in on what's really driving the economy over the longer horizon, ensuring your portfolio remains resilient and positioned for enduring opportunities.

If this felt a bit like going back to university, just consider it a refresher course — without the exams.

Warm Regards,

Nico