SECTOR INVESTING

AND

BUSINESS CYCLES

By: George Dagnino, PhD

Editor, *The Peter Dag Portfolio Strategy and Management*
Author: *Profiting in Bull or Bear Markets*
(Published by McGraw-Hill and translated in Chinese by McGraw-Hill Education)
Money manager, lecturer, economist
Since 1977

www.peterdag.com

FOREWORD

This is my second book and deals with “***Sector Investing and Business Cycles.***” It is a “work in progress” and is free to all investors who wish to learn about my research on the subject. The book’s content has been planned and drafted. I need to fill the blanks. Chapters are posted on this web site www.peterdag.com when I complete them.

Several friends are helping me in this endeavor.

Ed Pritchard has been instrumental in encouraging me to write it. He helped me in designing the flow of the material, the content of each chapter, and how to make the subject easier to understand.

Mary Ann Kenny and Lou Schott are following closely my efforts and are helping to edit the material. Their suggestions on how to streamline the presentation are very important and are making the subject much easier to read. I really appreciate the gift of their time.

You, the reader, have also an important role. Please send me your comments and suggestions. They will be greatly appreciated.

Good reading!

Best,
George

George Dagnino
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INTRODUCTION

Managing a portfolio is not easy. If someone tells you there is an easy formula to successful investing it is not true. Especially if you want to manage all your money, not just play money. A portfolio requires time, study, and analysis. If you want to manage play money, find someone who gives you tips, and go gamble. In order to manage all your assets, you need an investment process.

This book starts from where "*Profiting in Bull or Bear Markets*" concluded. *Profiting in Bull or Bear Markets* presented a detailed analysis of the relationships existing between financial markets and business cycles. In any economic system, business cycles impact financial markets and financial markets impact business cycles. That book provided a framework to understand these relationships and showed that history does indeed repeat itself.

What you learn in this book

- An investment process is based on the following decisions:
    a. What to buy or sell
    b. When to buy or sell
    c. How much to buy or sell
    d. Why to buy or sell
- The need to understand the business environment
- How the business environment affects the financial markets
- How to recognize the factors affecting the strength of a stock sector
- How to select the strongest stocks in the strongest sectors
- How to develop an action plan and develop an investment strategy
- How to establish an investment portfolio
- How to use the past performance of the portfolio to improve future profits

Most investors are not satisfied with their investment results because they do not have an investment process. In fact, investors may not know about an investment process. When markets rise, their portfolio performs well and investors feel satisfied with their financial results. In a bull market environment, any stock tip may show profits because a rising tide lifts all boats. Of course, as the market goes up, investors become confident that they are superb investors and that they do not need any help.

As a gradual and steady upward move of the market takes place, financial conditions change. Many investors do not recognize the meaning and implications of how these changes impact portfolio returns. When investors make money, they feel secure. Eventually, the gains do not seem to materialize anymore as they did earlier. Their portfolio begins to show mixed results. What to do?

At this point, typical investors convince themselves that the market is in a minor correction and think they should not worry. They do not take action because they are hoping that their stocks will come back. They may buy more of the declining stock thus averaging down their positions. Investors continue to lose money. They worry more and more about the market and begin to act irrationally.

Soon the market goes through a serious correction of 10 – 15%. The losses begin to accumulate and investors rationalize the painful losses. They put their heads in the sand and the losses become staggering. At this point, they are so disgusted with their portfolio performance they do not even look at their portfolio. They do not know what to do. This is why investors need an investment process.

The reason portfolios show disappointing results is because of the changing financial and economic environment. Investors need an investment process to accommodate these changes. An investment process answers the following questions:

1. What to buy and what to sell;
2. When to buy and when to sell;
3. How much to buy and how much to sell.

These crucial questions need to be answered often -- at least every month -- after evaluating the performance of the portfolio. An investment process lets data not emotions rule decisions.

The first question -- what to buy and what to sell -- addresses the issue of asset selection, purchase, and sale. To make a selection, the process must lead investors to make a decision to add or delete a particular asset in the portfolio.

The second issue -- when to buy and when to sell -- guides investors to time a purchase or sale of an asset. The need is for a method to find the correct and consistent answer.

Once you have selected and bought an asset, how do you manage the amount invested in that particular position? Some people think, “Buy.” Others think, “Sell,” or “Hold.” This is not the most successful way to look at investing. Investors should think in terms of how much to add or how much to sell from an existing asset. The objective of money management is to increase or decrease a position, gradually, reflecting changes in the financial environment based on the levels of risk of a particular stock, stock sector, or asset.

The investment process evaluates the relationship between financial markets and the business environment. Investors can determine the stock sectors most likely to outperform or under perform the market. Once the strongest stock sectors are targeted, techniques are developed to find the strongest stocks within the strongest sectors.

As the business environment changes, the strongest sectors become less attractive and other sectors become more attractive. Our investment process helps investors decide when to buy or sell, what to buy or sell, and how much to buy or sell. This dynamic approach to money management uses the attractiveness of stock sectors depending on the phase of the business cycle. For example, if the Fed aggressively lowers interest rates, financial sectors are likely to benefit. When interest rates rise, other sectors become attractive and financial stocks become risky.

As the economy changes, investment strategies and asset attractiveness change. The decision making process is dynamic. Investors adjust their strategy to changes in the business cycle.

The first step is to assess the economy with practical and useful indicators. We analyze the relationship between indicators to determine what is happening and what is most likely to happen. Then, we have solid tools to predict the market.

Part 1 focuses on identifying the likely direction of the economy, the stock market, short-term interest rates, commodities, inflation, bond yields, and the dollar. These important indicators need to be understood to choose the right assets for the right times. Our analysis enables us to develop an investment process and an action plan based on the most likely scenario.

Part 2 provides tools to select the market sectors most likely to outperform the market trends analyzed in Part 1. The market sectors and the companies in each sector are listed. Data sources for measuring the relative sector strength are explained.

The attractiveness of each sector is dictated by what happens in the business cycle. Each sector is analyzed to determine when the sector offers above average or below average investment opportunities. Guidelines help us select the most helpful economic indicators. The indicators help us decide which sectors to buy or sell. It is vital to know the favorable and unfavorable economic and financial factors influencing a sector before investing money in a specific stock in that sector.

Within the strongest sectors, the strongest stocks are chosen based on stock value, management effectiveness, and business model. For each sector, the analysis is applied to each candidate stock. What are the strongest financial and business variables affecting the price of a stock? If a growing money supply is strongly related to stock appreciation, investors can profit from knowing this relationship. The same approach helps us decide when to sell.

Part 3 provides practical guidelines to develop and implement an investment plan. Concrete steps are outlined and discussed to assemble a viable investment approach. We tell you where and how to find data to use in your investment process. Then, using these tools to establish an investment process, you can start your portfolio.

Measuring the performance of your portfolio gives useful insights into your strategy and how to react to changes in the value of your portfolio. This is important in the successful management of an investment portfolio. Performance data give investors useful information on the quality of their decisions. This assessment provides investors with guidelines to correct weak choices.

Chapter 1 explains the importance of an investment process and offers an overview of: setting realistic objectives, establishing a strategy with a disciplined methodology to measure and to respond to changes in the risk profile of the markets.

Chapter 2 offers the essential indicators needed to gauge financial and business environments.

Chapter 3 examines the relationships between indicators. These relationships provide a sense of timing. The risks of the financial environment are managed by focusing on turning points in these indicators.

Chapter 4 develops a detailed framework on how to develop a personal investment system. Understanding the economic environment and developing a series of forecasts for various assets provides direction for money allocation.

Chapter 5 introduces and defines the market sectors available to individual investors.

Chapter 6 examines the behavior of various sectors in terms of volatility and risk. Business and financial indicators are used to determine the type of environment or phase of the financial and business cycle. As the configuration of indicators changes, and a new financial environment develops, new sectors emerge and become more attractive.

Chapter 7 shows you an approach to select timely stocks within the selected sectors.

Chapter 8 through Chapter 11 include the analysis of the behavior of the business cycle from 1997 through 2004. These were turbulent years when fortunes were made and then lost. The material discussed in this book is applied to study the response of various asset classes and stock sectors to changes in the business cycle. The book ends by spelling out the conditions that will trigger then next great bull market in stocks.

The Best Sectors for Stages in Economic Cycle. Menu. Search.Â Timing the market by investing in sector funds may sound risky or irresponsible on the surface but it can be done wisely.Â Understanding the difference between market and economic cycles and how they are related to investment performance can help determine the best timing strategies and portfolio structure. For example, did you know that a bull market for stocks typically peaks and can begin declining before the economy peaks? In different words, a new bear market for stocks can begin even as the economy continues to grow, although at a very slow pace. Sector investing using the business cycle. It may be possible to enhance returns over an intermediate time horizon. Fidelity Viewpoints.Â Because of its narrow focus, sector investing tends to be more volatile than investments that diversify across many sectors and companies. Each sector investment is also subject to the additional risks associated with its particular industry. References to specific investment themes are for illustrative purposes only and should not be construed as recommendations or investment advice.