How to Read the Economy for Investment Opportunities and Employment.

A Guide to Understanding the Cycles and Outside Forces of Economic Development.

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1. Sign Post: Keep Your Eyes on the Central Banks

The global economy is managed by central banks, and every country has its own. In America, the central bank is called the Federal Reserve. The economists who run this bank are responsible for the economy's performance. When there are problems in the economy, these economists determine what the problem is. They then take action the following ways: increasing or decreasing the interest rate and increasing or decreasing the money supply. While using these tools, the economists have to analyze whether their strategy is hurting or helping the economy. Sometimes, their actions cause more harm than good.

Working as an economist at the Federal Reserve is harder than any other job. One major wrong decision can destroy the global economy. This shows how much the world is connected now. ***A central bank's actions affect other economies***. The Federal Reserve, in particular, is the most powerful central bank. When the Federal Reserve takes action, all the economies around the world are affected.

> *Think of the economy as a person, and the economists who work at central banks as doctors. These economists try to diagnose a disease in the economy, and they try to give the economy the right medication to make it better.*

> *The medication they give always has a side effect. So the economist has to find a balance between the treatment and the side effects to determine the right dose. Sometimes, the treatment's side effects can cause more harm than good. They can cause an allergic reaction in the economy, just as people are allergic to certain medications. I will explain this in the Power of Interest Rates section.*

Since central banks control the global economy, you must always keep an eye on their actions. ***Are they increasing or decreasing interest rates? Are they expanding or contracting the money supply?*** I don't have enough space in this book to tell you how to invest when central banks take action (I plan to write a book dedicated to this subject). I will, however, go over the effect of an increase or decrease in interest rates.

The Power of Interest Rates

The interest rate set by the central bank touches everything in the economy. There is nothing that the interest rate doesn't affect. It affects every business and every person—even you.

Let's imagine that the Chairman of the Federal Reserve decides to raise the interest rate to control inflation. He notices that prices are rising too fast, and he wants stabilize them to improve the economy (he wants to give the economy some meditation). ***Let's think together about how this would affect the entire economy***. When the interest rate increases, it increases anything related to money; specifically, it increases the cost of borrowing money. So, a rise in the interest rate increases the cost of loans. What happens when the cost of loans increases? Your monthly payment on the same loan amount will be higher, which means car and real estate sales will go down. Most people don't pay cash for cars and real estate; most people buy real estate through loans, and the same is true for cars. It's rare that people walk into a car dealership and buy a car with cash. Banks love giving loans on secured assets, like cars and homes, and borrowers benefit by lowering their out-of-pocket expense. So if the cost of loans is higher, then fewer people are going to buy cars and real estate because the monthly payments of these assets are now more expensive. ***This causes car company stocks and real estate prices to go down***. At a greater level, higher interest rates cause fewer people to take out loans to start new businesses, and it causes established businesses to take out fewer loans to expand their operations, ***which will make bank stocks go down. This causes the entire economy to slow down; a slower economy means the stock market as a whole will go down***.

Not only will the stock market go down because of an increase in interest rates, but more people will want to keep their money in their bank accounts. An increase in interest rates increases the amount that banks pay on your savings (the money in your bank account). This means that people are making a higher return on their money in the bank, and they will be less willing to put their money at risk by investing in the stock market. ***That is a side effect of increasing the interest rate.***

The Effect of Interest Rates on the Global Economy (Very Important to Read)

Suppose this increase in interest rates means that the interest rate in America is now higher than the interest rate in Germany. The big investors who manage big money are affected by this rise. One percent return on tens of millions of dollars makes a big difference to them. This makes U.S. bonds more attractive to foreign investors because they give a higher return than German bonds. Many foreigner investors will now buy U.S. bonds, and their investments will be deposited in U.S. dollars. ***This increases the demand for dollars***. Using principles of supply and demand, it's easy to understand that ***the increase in demand for dollars will cause the value of dollars to go up. So an increase in interest rates causes the American dollar to increase in value relative to other assets***.

An increase in the interest rate is the first event; the dollar appreciating in value is the second event (this is what I meant by second event). Why? Because when this happens, commodities like gold, corn, wheat, soybeans, etc. will go down. Why? Because the world buys these commodities globally in dollars. If the dollar is valued higher globally, dollars now buy more of any commodity (copper, gold, etc.). If you were to buy gold from Africa after an increase in interest rates in America, you would now be able to buy more gold for the same amount of dollars. ***An increase in the dollar also causes a decrease in oil prices*** (oil is a commodity). ***Lower oil prices means lower transportation costs, so food prices will decrease (reducing inflation) and people will start driving more***. That's why I buy and sell commodities using economic sign posts such as the interest rate.

Also, I want to emphasize that investing in commodities is more lucrative than investing in the stock market. Besides, commodities are a physical asset, meaning they will never vanish. You are investing in a real asset; you are not investing in a company that can go bankrupt because management made a mistake.

> *Through working in the gas business I noticed that when oil prices go down, oil company stock prices (Chevron, ExxonMobil, Conoco Phillips, Valero, etc.) go down as well. And when oil prices go up, oil company stock prices also go up. This one trend has made me great returns over the years. When I look to invest in oil companies, my signal is*

> *the price of oil. When oil is at its low and it begins trending upward, that is my signal to invest in oil companies. And when oil is at its high and it begins trending downward, that is my signal to sell their stocks.*
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> *This is one example of how I connect commodities to the stock market, and this principle works with any commodity, not just oil. For example, you can buy physical copper (the commodity) or buy shares in a copper mining company (company stock). If the price of copper in the commodity market goes down, the price of the copper mining company stock will likely go down as well because its profit margin is based on copper prices.*

Why Does the Federal Reserve Increase or Decrease Rates?

So why does the Federal Reserve increase the interest rate? There are many reasons. Number one is to control inflation, or higher prices. The government and the central bank don't want the public to feel the effects of inflation. If prices get too high, then people won't be able to pay for food and housing, which causes social unrest among the people (many riots around the world and throughout history started when food prices got to high). ***So to prevent prices from rising more, the Federal Reserve increases interest rates, which causes the dollar to become stronger and prices to go down***. Also, the central banks increase interest rates to experience a greater return on the money they lend to the government and other banks. ***It's in the central bank's interest to increase interest rates because if the interest rate is lower than the inflation rate, the government's money becomes worth less***. However, when the central bank does this, it causes all the side effects that I mentioned earlier. The outcome is a stronger dollar and lower prices, but it comes at the cost of slowing down the economy. A slower economy ruins the stock market and real estate market, and causes unemployment to go up. This illustrates how everything is connected in the economy, and how these connections are important for strategically investing your money. ***The people who understand these connections are the ones who can make a killing in the financial sector***.

If interest rates go down, then the opposite of everything above happens. ***The dollar will decrease in value and commodities will increase in value***. More people will take out loans to buy cars, real estate, and businesses, while businesses will take out more loans to expand their operations. More jobs will be created by corporations and the government, causing unemployment to go down. However, this also comes at a cost—higher prices. When the Federal Reserve reduces interest rates, everything relative to the dollar increases in value, and you perform your investing the opposite way that you did when interest rates went up. If you follow the sequence, you can make a killing again and again when interest rates go up or down.

2. Sign Post: Economic Growth

How many times have you heard on the news conversations about economic growth? "The economy grew by 2% this quarter," or, "The economy experienced negative growth for the third consecutive month." What does economic growth mean and why do we pay so much attention to the "growth rate"?

> ***It's a shame that this is not taught in elementary school, and what's more of a shame is that economics is made to be complicated when it's a fairly simple subject***. *So don't be overwhelmed. It's not*

important that you memorize the details, but that you understand the connections of these economic principles to the big picture of what's happening in the financial markets. When you see the big picture, that's when you will make big money with your investments.

The growth rate helps us determine how much our income is increasing or decreasing as a country. This is important because if our total income grows significantly, then the unemployment rate of our country is reduced significantly (typically). What's confusing is that economists and news anchors don't talk about our income; they instead talk about ***GDP (gross domestic product)***. GDP measures how many goods and services were produced in the country, and is calculated by adding the total consumption, investment, government spending, and net exports (exports minus imports) that took place within a given period of time. The equation looks like this.

GDP = C + I + G + NetX

The "C" part of the equation refers to how much consumers spent on goods and services. Any transaction, from buying a car to buying groceries from the supermarket is counted in this. The "I" stands for how much people and companies invested. Investments include buying real estate and factories, hiring new workers, buying stocks, etc. The "G" stands for government spending, and includes what the government spent on the military, government workers, education, construction, new bridges, etc. The "NetX" stands for net exports, which are the goods and services we sold to other countries minus how many goods and services we bought from other countries.

The second most basic principle of economics (after supply and demand) is that GDP = GDI, which is our gross domestic income. This means that how much we produce (GDP) is equal to how much we make in income (GDI) as a whole country. This is theoretically true. In the real world, however, there are small differences between GDP and GDI. I don't want to get into why this is the case because it's not important. ***What is important is that GDP and GDI are practically the same, and the growth rate is a major sign to pay attention to***.

> *When people go to the mall to shop for clothing; when investors spend money on expanding their businesses; when the government spends money on workers and new projects, and when we export goods to others countries, all of these actions create income for people. The store that is selling you clothing is making money when you buy that item (if more and more people buy clothes from that store, that company's stock price will go up, which is another sign for you to take advantage of). That money is going into the hands of the owner and employees as income. Investors who are expanding their businesses are spending money on new employees, construction, and real estate; which are all forms of income for people (employee income, construction worker income, real estate commissions). Since the spending creates jobs and income, it reduces the unemployment rate.*
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> *When the government spends money on the military and public jobs, that money is going into the bank accounts of soldiers and government workers. And when people export goods to other countries, they are making income on the goods they sell.*

The Relationship between the Growth Rate and Unemployment

So to keep things simple, whenever you hear people talk about GDP, think of our collective income as a nation:

GDP = Total Income of the Country

For example, when our economy grows by two percent, it means our collective income grows by two percent. An increase in income means more businesses opened, more goods were exported, and more consumer goods were sold. In other words, it means a better economy; it means more jobs are created and more people are making money.

> ***For unemployment to go down significantly, the growth rate needs to be higher than 4%****, because many companies will begin to hire workers at that rate. Without this level of growth, unemployment remains stagnant, or even worsens. That's why we have not seen unemployment go down significantly since 2010.*

If the growth rate goes down from one quarter to the next, that means businesses' profits were not high. It means that fewer consumer goods were sold. ***Fewer goods sold means that you can expect the stock market to go down***. The health of the stock market is determined in large part by corporate earnings (how much companies made). If companies aren't experiencing an increase in income (which can be seen by the growth rate), then their stock prices typically go down. Also, a lower growth rate means people's income went down. ***With less income for both companies and individuals, unemployment goes up, which means commodities will temporarily go down***. Less income means people have less money to buy commodities, which means commodity prices will go down (creating an excellent opportunity to buy commodities). Temporarily, a lower growth rate scares investors overseas who now want to switch from investing in America to investing in other countries. ***Immediately, with a lower U.S. growth rate, the euro price will go up***, which means the dollar price will go down (meaning it's a great time to invest in the foreign currency exchange). Immediately, you will experience the same sequence of events of a weaker dollar that I mentioned in the previous section. If the dollar becomes too weak and prices go too high, the Chairman of the Federal Reserve will raise interest rates to protect against inflation, which causes another chain reaction of events to happen that creates opportunities to make money.

> *So when our growth rate goes down, invest immediately in foreign currencies. Sell your stocks and commodities and focus on foreign currencies. When the growth rate goes up, do the opposite— invest in American stocks.*

Hopefully by now, you understand what I meant earlier by economic connections.

How Real Estate is Connected to Unemployment

When real estate prices go down, building a new house becomes very expensive for construction companies (what they can sell new real estate for is much less than it was at the peak of the real estate market). So construction will slow down and fewer houses will be built. This increases unemployment because many construction workers will be out of work. ***Construction workers make up a large part of the workforce, which means that a slowdown in real estate construction has a big effect on employment levels (this is one of the major reasons why***

the unemployment rate went up after the economic collapse).

Sometimes it's in the government's interest to increase real estate prices, even if done through artificial factors. Why? Because they want to make it attractive for construction companies to build new homes. If prices are low, there is no incentive to build; but if prices go up, then real estate development becomes lucrative again. This will cause companies to want to build, and they will begin to hire more workers, which will reduce unemployment.

> ***Since the financial crisis, the central bank has kept interest rates low. This artificially increases demand for real estate, which causes prices to go up. Also, the government has created numerous programs to help banks prevent foreclosures (such as loan modifications). This is another artificial way to fix prices because it reduces the supply of houses for sale***.
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> *And there are other artificial factors, such as financial institutions buying hundreds of homes (as I mentioned before), that causes prices to go up.* ***All of these artificial factors are bringing real estate prices up, meaning real estate is not naturally increasing in value****. Over time, real estate will become risky because these artificial factors could be creating the next bubble that explodes.*

3. Sign Post: Volatile Stocks and the Global Economy

We are living in a world full of opportunity. This is especially true in the financial sector, where stocks, ETFs, foreign currencies, and commodities are being traded globally. As an American citizen,