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Always a Winner

Finding Your Competitive Advantage in an Up and Down Economy

THE SUMMARY IN BRIEF

Most companies make a lot of money during economic expansions and lose a lot of money during recessions, but it doesn't always have to be that way.

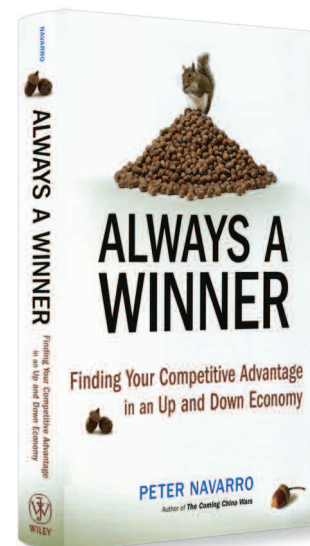
In this summary, economist and author Peter Navarro shows you how your organization can be a winner over the course of its *entire* cycle — not just when economic times are good. *Always a Winner* arms you with all the strategies, tactics and forecasting tools you will need to profitably manage your organization through every business cycle season — from the best of boom times to the worst economic slumps.

Practical and insightful, in *Always a Winner* Navarro offers immediately useful advice to help your company survive and thrive in the increasingly risky conditions of the 21st century.

Navarro's call to action is simple: If you really care about your organization, you will learn to strategically manage the business cycle to create a powerfully competitive and sustainable advantage over your rivals. In the end, you will attain the superior financial performance sought by every executive team in the world.

IN THIS SUMMARY, YOU WILL LEARN:

- How to forecast movements and key recessionary turning points in the business cycle.
- How to implement a set of “battle-tested” strategies over the course of the business cycle.
- How to rebuild your organization with a broader strategic business cycle orientation.
- How to make your organization more recession-resistant and resilient over the long term.



by Peter Navarro

CONTENTS

A Big Picture View of the Always a Winner Organization

Page 2

Becoming Your Own Economic Forecaster

Page 3

Why the GDP Equation Is Your Most Important Forecasting Tool

Page 4

Why the Bond Market Is Not a Casino

Page 5

Why Companies Often Price Their Products and Manage Credit Exactly Wrong

Page 6

Building the Always a Winner Organization

Page 7

THE COMPLETE SUMMARY: ALWAYS A WINNER

by Peter Navarro

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A Big Picture View of the Always a Winner Organization

A recession can do far more damage to your organization than any 10 competitors. Without question, it is one of the most important lessons this business executives around the world have all-too-painfully learned in the wake and carnage of the crash of 2007 to 2009.

Contrary to a popular view before that historic crash, the business cycle is not dead. Nor has this highly volatile and often destructive cycle even been tamed. This is a lesson sharply underscored by the culpability of America's own Federal Reserve and central banks around the world in helping to trigger the crash of 2007 to 2009 by first creating, and then perpetuating, a bubble global economy.

Because recessions can do far more damage to your organization than your competitors and because recessions will continue to be as inevitable as death and taxes, the 2007-2009 crash should serve as every business executive's epiphany about the need to recession-proof one's organization.

By learning to strategically manage the business cycle, your organization will be able to create a powerful competitive and sustainable advantage over your rivals and thereby find the grail sought by every executive team in the world: superior financial performance. In this way, you will be "always a winner."

What Are the Three Steps to Becoming an Always a Winner Organization?

In order to always be a winner, your organization must become a Master Business Cycle Manager by following these three steps:

Step One. Develop and deploy strong forecasting

capabilities to anticipate movements and key turning points in the business cycle and effectively disseminate that forecasting information to key decision makers.

Step Two. Apply well-timed business cycle management strategies and tactics across the functional areas of your organization in a synergistic and integrative fashion in response to your forecasting data.

Step Three. Over the longer term, build your organization with a strong business cycle management orientation, an executive team with a high degree of economic and financial market literacy, and an organizational structure and culture that strongly support and facilitate all strategic business cycle management activities.

By following these steps, your organization will not only recession-proof itself when the business cycle comes crashing down, it will also gain a competitive advantage over its rivals while minimizing costs, maximizing profits and increasing market share. In this way your organization will achieve superior financial performance and always be a winner over the entire course of the business cycle.

How to Strategically Manage Through the Business Cycle Seasons

Here is a broad overview of each of the major principles of strategic business cycle management:

• **Production, Inventory and Supply Chain Management.** The astute strategic business cycle manager is even more vigilant about the dangers of a recession when economic times are at their very best. In anticipation of a recession, the strategic business cycle manager begins to trim both product inventories and the inventories of the raw materials and components necessary to produce the products.



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Summary: ALWAYS A WINNER

- **Human Resources Management.** If the desire is to trim labor costs during a recession, the time to start doing that is well before the recession hits. The Master Cyclist (short for “Master Business Cycle Manager”) executive team uses the deepest and darkest days of a recession to cherry pick the very best new employees for its company from a talent pool now swollen with some of the very best and brightest from the industry.

- **Advertising and Marketing.** There is a mound of research indicating that counter-cyclically increasing advertising during a recession is one of the fastest ways to build brand and seize market share. Not only are advertising rates cheaper, but there is far less congestion in the advertising market, and messages are thereby heard much more clearly.

- **Pricing the Cycle and Credit Management.** Price elasticities generally become *more elastic* as a recession takes hold, thereby making products more sensitive. That’s why, as a Master Cyclist rule, you always want to be cutting your prices as the economy softens.

- **Capital Expansion and Modernization.** By counter-cyclically increasing your capital expenditures to build new plants and modernize existing ones, your organization will be first to market with products that reflect the latest innovations and styles.

- **Acquisitions and Divestitures.** “Buy low and sell high.” That’s the Master Cyclist mantra when it comes to executing your organization’s acquisition and divestiture strategy.

- **Capital Financing.** Shave a couple of hundred basic points off your capital costs over the course of the business cycle and save your organization millions of dollars. That’s the mindset every Master Cyclist brings to the capital financing table. In this critical dimension, corporate finance teams have at least two parameters to optimize: the organization’s debt-to-equity ratio and its ratio of short-term to long-term debt. ●

Step I: Becoming Your Own Economic Forecaster

Before learning how to become your own economic forecaster, it’s useful to learn about both how and why the business cycle moves and the various forces that can trigger a recession. A useful starting point for this discussion is to introduce one of the most powerful forecasting tools, the GDP (Gross Domestic Product) forecasting equation.

The economic growth of any nation is measured by its GDP. As a practical matter, GDP growth is driven by

only four components: consumption, business investment, net exports and government spending. By using a select set of leading economic indicators and reports to track each of these major GDP components, any business executive can develop a very keen sense of the movements and key turning points of the business cycle.

GDP Changes Chart the Business Cycle

The real, inflation-adjusted percentage changes in the GDP not only help us chart business cycle movements, the quarterly and annual GDP growth rates also provide a very useful benchmark for the health of any economy.

The GDP forecasting equation may be usefully represented as follows:

$$\text{GDP} = \text{C} + \text{I} + (\text{X} - \text{M}) + \text{G}$$

In this equation, **C** stands for consumption and **I** stands for business investment. The term **(X – M)** represents net exports, which is simply the difference between the amount of exports, **X** (what a country sells to other countries), and the amount that country imports, **M** (what a country buys from abroad). Finally, **G** stands for government spending, and often, during a recession, the government is called on to be the spender of last resort to stimulate an economy out of the doldrums.

Understanding that any given recession can alternately be consumer-led, business investment-led, export-driven, triggered by misguided fiscal or monetary policies or precipitated by a major exogenous shock such as a steep oil price hike, is a critical step toward developing your own forecasting capability.

How to Forecast the Business Cycle in Four Easy Pieces

While any organization that is serious about forecasting the business cycle should use one (or both) of the traditional forecasting tools — an in-house model or an outside subscription service — this is merely the start, rather than the end, of your organization’s forecasting duties. Indeed, the task of forecasting the business cycle cannot be delegated to a remote group of economists. Rather, *every executive must learn to become his or her own business cycle forecaster.*

A relatively simple but very powerful forecasting method relies on these tools:

1. Monitoring the shape of the bond market’s yield curve.
2. Assessing the stock market’s bullish or bearish trend.
3. Following the corporate earnings calendar and, most important:
4. Tracking the GDP forecasting equation.

Why the GDP Equation Is Your Most Important Forecasting Tool

By using a relatively select set of leading economic indicators and economic reports to track all five major components of the GDP equation, any business executive can anticipate movements and key expansionary and recessionary turning points in the business cycle.

By individually tracking consumption, investment, net exports and government spending, you will become a much more accurate forecaster and be able to spot recessions much sooner. Any given recession may be triggered by any one of the four forces driving the GDP. In this sense, tracking each of the individual GDP components serves as an early warning system.

Another important reason to track the individual components of the GDP equation may be gleaned from this critical point: Even if the broad economy does not succumb to a recession, a fall in any one of the GDP components might hit your own organization very hard.

Why Tracking the Consumer Is the Ultimate Confidence Game

In order to properly track the consumption component of the GDP equation, it is useful to think in three dimensions:

1. How much is the consumer willing to spend? This is a function of the consumer's mood and confidence.
2. How much can the consumer afford to spend? This depends on the consumer's "budget constraint," which is a function of *both* the consumer's income *and* wealth.
3. What is the consumer actually spending his or her money on? Is it big-ticket items, such as cars and houses, or, fearful of a recession, are consumers shifting their spending patterns toward nondurable goods, such as food and medicine?

Why Taking the Pulse of Business Investment Is as Simple as ISM

Conceptually, business investment can be divided into two categories: fixed investment and inventories. *Fixed investment* includes everything from new factories and office buildings, to computer equipment, machine tools and assembly-line robots. *Inventories* are what pile up when a recession hits and what gets depleted during a robust economic boom.

In general, it is the fixed investment component of the GDP that strongly drives economic growth; inventory levels help signal the relative strength or weakness of the economy.

The Institute for Supply Management is the largest

supply chain management association in the world, and the monthly release of its ISM index data is eagerly awaited by business and government leaders as well as the financial markets. This is because the ISM index has had an excellent track record of signaling business investment-led recessions.

Because of its success in signaling past investment-led recessions, the ISM index should be one of the most important weapons in your personal forecasting arsenal.

How Falling Exports Can Flatten an Economy in a Flat World

Properly analyzing America's International Trade report and, more broadly, understanding the roles of differing trade patterns as potential recessionary triggers require a much higher degree of economic and financial market literacy than interpreting other elements of the GDP forecasting equation.

To understand the messages of the International Trade report, it is critical to understand such complex relationships as those that exist among interest rates, inflation, oil prices, exchange rates and trade flows as well as basic economic concepts, such as the price elasticity of demand.

This is precisely why, in an era of globalization, every business executive must commit not just to becoming his or her own economic forecaster but also to improving his or her own economic financial market literacy.

Why Uncle Sam Is the Spender of Last Resort

The best way to monitor government spending is to review the U.S. Treasury Budget report on a monthly basis. This report provides a running estimate of the annual budget deficit as economic conditions change.

Today, as the U.S. government and governments around the world continue to up the fiscal stimulus ante dramatically — and the U.S. debt burden rockets past \$12 trillion — the world is faced with a ticking budget-deficit time bomb of unprecedented proportions. The bottom-line implication of this gloomy longer-term picture is that, over time, *chronic budget deficits are increasingly likely to threaten your organization's ability to borrow capital at reasonable interest rates.*

Budget deficits can also be highly inflationary; and once such deficit-induced inflation hits, the Federal Reserve must respond with interest rate hikes that will hamper your ability to raise capital and will likely trigger a recession. For all these reasons, it is critical that you and your executive team closely monitor the U.S. Treasury Budget report on a monthly basis.

How Do I Fear Thee, Inflation? Let Me Count the Ways

While *demand-pull inflation* comes from too much money chasing too few goods, *cost-push inflation* comes about when the economy suffers from an energy price shock or a food price shock. Here's why this distinction is so important: While any increase in demand-pull inflation is likely to increase the chances that the Federal Reserve will *raise* interest rates, any increase in cost-push inflation actually *reduces* the possibility of a rate hike.

Core inflation represents demand-pull inflation while non-core inflation represents cost-push inflation. And note, the reason why energy and food prices are excluded from core inflation is that they are considered to be highly volatile. While food and oil prices may rapidly go up, they also often rapidly go down.

Follow the inflation indicators as part of your GDP forecasting equation protocol because inflation can trigger a recession both directly and indirectly. And know the difference between demand-pull and cost-pull inflation and how the Fed is likely to react to each.

Why the Bond Market Is Not a Casino

If the price of a bond goes *up* and the interest rate paid on that bond doesn't change, the effective yield of the bond has to *fall* because the bond buyer has paid a higher price for the right to earn the same return. From this example, we see a relationship absolutely critical to understanding how yield curves invert. In particular: Bond yields are inversely related to bond prices. Thus, if investors drive the price of, say, the long bond up through increased demand, the yield of the long bond will fall.

The bond market is decidedly *not* a gambling casino. Rather, the bond market is much more like a very sophisticated forecasting tool.

The intelligent speculations of a myriad of very informed investors can reveal the likely direction on the business cycle. Given the yield curve's remarkable accuracy in predicting key recessionary turning points in the U.S. economy over the last 40 years, any business executive who ignores the collective wisdom of the yield curve does so at his or her own peril.

Why Forecasting a Recession Is No Bull (Market)

In general, the earnings of most companies rise in economic expansions and fall during recessions. Accordingly, any stock market investor who believes the business cycle will be in an expansionary mode is likely to be bullish and buying stocks. If the majority of invest-

How to Follow the Always a Winner Indicators and Reports

The best way to follow the leading indicators and reports is by doing something that every business executive should do every business day anyway: Read the financial press. The recommended indicators and reports are covered extensively in publications such as *Barron's*, *the Financial Times*, *Business Daily* and the *Wall Street Journal* as well as by financial news networks such as CNBC and Bloomberg.

ment dollars in the stock market reflects this bullish position, the stock market trend will be up on the consensus speculation that the economy will continue in its expansionary mode.

If, however, stock market investors anticipate that a recession is on the horizon, they will begin selling stocks. If enough stock market investors become net sellers, any bullish uptrend will quickly morph into a dangerous bearish downtrend. Any such downtrend may signal concerns that a recession may be on the way — or that a recession in progress may continue for the foreseeable future.

Together with the bond market's yield curve spread, the stock market provides business executives with extremely important information with which to guide their companies through an up-and-down economy. Accordingly, any executive who ignores the messages of the stock and bond markets is just plain foolish.

How the Corporate Earnings Calendar Literally 'Guides' Your Strategy

Like clockwork, every quarter on Wall Street, the earnings season rolls around; and during this season, every publicly traded corporation must publish a quarterly earnings statement. For stock market investors interested in individual companies, the earnings season provides a wealth of information.

In using the corporate earnings season as a forecasting tool, there are two important questions to ask:

1. Did the majority of the companies meet, miss or exceed their earnings targets?
2. Did the majority of firms "guide" their forecasts higher or lower, or leave their guidance unchanged? (The term *guidance* refers to the fact that most companies also provide in their earnings announcements whether they expect next-quarter earnings to be above or below the levels previously forecast.) ●

Step II: Always a Winner Strategies Through the Business Cycle Seasons

Now that we have finished Step One in the Always a Winner management process and you have learned to become your own economic forecaster, it's time to put your ability to anticipate movements and key turning points in the business cycle to work. That's where Step Two comes into play.

In Step Two, we learn how to implement a very powerful set of strategies at key points in the business cycle.

The Always a Winner strategies can be grouped according to seven specific functional activities:

1. Production, inventory and supply chain management.
2. Human resources management.
3. Advertising and marketing.
4. Pricing and credit management.
5. Capital expenditures.
6. Acquisitions and divestitures.
7. Capital financing.

Production, Inventory and Supply Chain Management

In anticipation of a recession, Master Cyclists begin not only to cut production and inventory. They also cut their purchases and stockpiling of whatever raw materials, components and other production inputs they might need for their factories and facilities.

The Master Cyclist executive team is always seeking to balance the costs of holding inventory versus the costs of not having enough inventory on hand — so-called stock-out costs. In this regard, as a recession looms, the downside risks of holding too much inventory quickly overtake the rewards of having enough products on hand for distribution and sale.

It's not just the bottom recessionary part of the business cycle that the Master Cyclist worries about in managing the supply chain. The Master Cyclist also understands that: It is equally important to ramp up production and begin building inventories during a recession as soon as a recovery appears to be on the horizon. In this way, the Master Cyclist will be first to market with the most innovative goods that it is able to produce.

Why Cherry Picking the Talent Pool During Recessions Is Your Quality Key

The Master Cyclist executive team not only avoids the recessionary trap of exuberantly over-hiring and any

attendant mass layoffs and blows to morale. It uses the deepest and darkest days of a recession to cherry pick the very best new hires for its company from a talent pool, which includes laid off talent. In this way, this well-timed strategic business cycle management strategy exploits recessions to improve the quality of the organization.

An excellent example of such cherry picking is offered up by Microsoft's rapid response to Yahoo!'s mass layoffs and plunging morale during the 2007 to 2009 crash. In one brilliant move, Microsoft hired Qi Lu, a former top Yahoo! search and marketing executive and pioneer in search engine technology. He wound up as the president of Microsoft's Online Services.

Why Countercyclical Advertising Is the Best Way to Build Brand and Market Share

Recessions are the best time to increase your advertising for at least two reasons:

1. Advertising levels are generally down so there is far less congestion in the advertising market. This allows your advertising messages to be heard far more clearly and far more sharply — particularly if your rivals are in full retreat.
2. Here the laws of supply and demand work very much in your favor: Advertising rates are a lot cheaper so your company and its products get a lot more bang for the advertising buck.

Strategically, it is of course important for your advertising campaign to continue to focus on increasing unit sales during a recession. However, it is strategically even more important to broaden your advertising campaign in a way that focuses more on the longer-term goal of building your brand.

Why Companies Often Price Their Products and Manage Credit Exactly Wrong

While most business cycle management strategies are implemented countercyclically, the rule for properly pricing the business cycle is to do so *procyclically*. As a general rule, you should raise your prices when the economy is expanding to boost revenues. Even more critical to protecting your bottom line — and market share — you should cut prices when the economy is entering a recession.

Master Cyclist organizations never allow their accounts receivable to get out of hand. At the first sign of any possible recession, these organizations begin to pull in their accounts receivable more aggressively even as they begin to tighten credit. In this way, the Master Cyclist credit manager pre-emptively any problem of uncollectible receivables.

How to Not Get Run Over by the Capital Expenditures Bandwagon

When it comes to capital expenditures, your Master Cyclist management mantra should be:

- Cut capital expenditures in anticipation of a recession to build up your cash position and avoid overcapacity.
- Increase your capital expenditures during recessions so as to be first to market with products that reflect the latest innovations and styles.

Far too many organizations engage in just the opposite kind of investment behavior.

Why You Should Buy Low and Sell High Over the Stock Market Cycle

It is essential that any executive team obey this all-important maxim: *Any acquisition must be accretive to earnings.*

In a Master Cyclist and an Always a Winner context, this maxim means that no matter how attractive an acquisition may seem from a strategic perspective, if its purchase price is too high, that acquisition will *never* be accretive to earnings. To put this crucial point another way: Any overpriced acquisition — no matter how many benefits it may convey — will never overcome its high costs and add to the company's bottom line.

One Always a Winner point should be abundantly clear: If you conserve your cash and are patient during a bullish upward trend of the stock market cycle, you will be loaded for bear once a bear market hits.

How to Minimize Your Capital Financing Costs Over the Interest Rate Cycle

Shave a couple of hundred basis points off your capital costs over the course of the business cycle and save your organization millions of dollars. That's the mindset every Master Cyclist brings to the capital financing table.

In this critical Always a Winner dimension, corporate finance teams have at least two parameters to optimize: the organization's debt-to-equity ratio and its ratio of short-term to long-term debt. Both of these parameters change over the course of the business cycle and the related stock market and interest rate cycles. Only by strategically exploiting these cyclical changes in the debt-to-equity and short-term to long-term debt ratios over time will your capital financing costs truly be minimized. ●

Step III: Building the Always a Winner Organization

For you to engage in truly effective strategic business cycle management over the many different functional

Strategy and Structure

The reigning authority on both the necessity and virtue of organizations adapting to reflect their changing strategy is the noted Harvard Business School historian Alfred Chandler. In his classic book *Strategy and Structure*, Chandler astutely noted that structure must always follow strategy.

areas of the organization and over the longer term, it is critical that you learn to rebuild your organization to reflect its new strategic intent.

To become a truly effective strategic business cycle manager, an organization needs to possess these four characteristics:

1. A strong business cycle management orientation.
2. An executive team that facilitates the flow of forecasting data and timely decision making.
3. An organizational structure that facilitates the flow of forecasting data and timely decision making.
4. An organizational culture that supports business cycle management activities.

What Is a Business Cycle Management Orientation?

The term *business cycle management orientation* refers to the recognition by the organization's executive team that recessions represent not only potentially extreme dangers. More broadly, movements and key turning points in the business cycle represent potential sources of competitive and sustainable advantages as well as important determinants of both the flow and stability of future earnings.

Beyond an overriding awareness of business cycle movements and the strategic opportunities that recessions in particular present, a strong business cycle orientation also emphasizes this critical point: Truly effective strategic business cycle management is ultimately a learning process based on an organization's cumulative experience with dealing with past adversity.

How Every Executive Team Can Boost Its Economic and Financial Market Literacy

Regardless of why far too many members of America's business executive corps may be characterized by a relatively low level of economic and financial market literacy, it is critical that the literacy bar be raised. To raise this bar requires both a commitment to the daily discipline of reading the financial press and a longer-term commitment to training programs that systematically upgrade the business cycle management skills of the executive team.

Summary: ALWAYS A WINNER

In reading the financial press, it is essential for every business executive to very *quickly* and *intelligently* read at least three newspapers a day: the *Wall Street Journal*, the *Financial Times* and *Investor's Business Daily*. The *Economist* offers the latest in global financial news.

Why a Facilitative Structure Must Follow Your Business Cycle Management Strategy

What kind of structure must your organization develop to strategically manage the business cycle effectively and efficiently over the longer term? The answer may be found in three specific structural dimensions:

1. Your organizational structure must facilitate the timely acquisition, processing and dissemination of forecasting information.
2. Your organizational structure must facilitate the equally timely, synergistic and integrative implementation of strategic business cycle management principles.
3. Both your forecasting and strategy-setting capabilities must be integrated across the firm and not segregated in separate shops far from the centers of power and command.

The bottom line is that building an organizational structure that is fully capable of supporting your strategic business cycle forecasting and management activities is absolutely critical to the long-term success of your organization. Time spent on this critical task will be time very well spent indeed.

Why a Supportive Organizational Culture Is Essential to Always Being a Winner

When it comes to cultivating a supportive organizational culture for its strategic business cycle management activities, no company does it better than Intel — except perhaps the big-rig truck manufacturer Paccar.

Paccar operates in one of the most cyclical of industries. Nevertheless, the company has been able to turn a profit consistently for almost 70 years. As evidence of both its business cycle orientation and its high degree of business cycle literacy, Paccar's top management team has adopted a strategy of geographically diversifying risk. Paccar's team also closely follows key industry indicators (e.g., freight tonnage) and prides itself on its almost accordion-like ability to ramp up and ramp down its production at the first sign of recovery or recession.

A major part of Paccar's nimbleness may be attributed to the company's own pragmatic and supportive organizational culture. As one assembly line operator described it: "Workers appreciate how [executives] don't go into denial or stonewall when a downswing is coming. They

are frank and open about cuts, and ... relations between the company and its unions seem to be good."

To build this supportive culture from the ground up, at every new employee orientation, workers are warned that the truck business is cyclical and some layoffs are almost inevitable. It is in large part because of this early warning and frankness that once the economy recovers, loyal workers typically find their way back to Paccar's factories rather than those of the competition. In this way, Paccar's organizational culture allows it to retain much of its highly skilled work force even though many of its members are laid off periodically. The cultural payoff: considerable savings in recruitment and training costs and its accordion-like ability to control labor costs during downturns.

How to Protect Your 401(k) in an Up-and-Down Stock Market

The best way to completely diversify diversifiable risk is simply to hold the broad market, for example, by holding a mutual fund or exchange-traded fund representing the S&P 500 Index.

While holding the broad market may do an excellent job of protecting your portfolio from diversifiable company and sector risks, it does nothing whatsoever to protect you from the market risk associated with holding a portfolio through the up-and-down movements of the business cycle!

By learning how to be your own business cycle forecaster and by following stock market trends, you will not only learn how to manage your organization much better. You will become part of that small elite group of smart money and thereby manage your own money and retirement funds much better.

If you become your own economic forecaster, you will not only develop a much better sense of the broader economic conditions within which your business operates. You will also ensure that a recession never again catches you and your organization by surprise. ●

RECOMMENDED READING LIST

If you liked *Always a Winner*, you'll also like:

1. ***Outsmart!* by Jim Champy.** Identifies the counterintuitive lessons learned by companies able to sustain super-high growth for at least three years.
2. ***The Granularity of Growth* by Patrick Viguerie, Sven Smit, Mehrdad Baghai.** This book teaches executives how to follow a detailed approach to uncover potential growth options.
3. ***The Momentum Effect* by J.C. Larreche.** Harness the power of the momentum effect, adaptable by any business under any market condition.