

Perpetual knowledge bank series: cyclical stocks

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Cyclical stocks are companies which typically rise and fall with the business cycle. The share prices of these companies are generally correlated with how the economy is going such that they are likely to rally (increase) when the economy is growing or vice versa, the share price may come under pressure when economic growth contracts.

The prices, revenues and profits of goods and services provided by cyclical stocks are typically in sectors more sensitive to the business cycle like energy, resources, travel, retail, restaurants and automobiles. As a result, the earnings and profits of the cyclical stocks may be boosted when the economy is growing. However, when the economy experiences a downturn, consumers usually forgo the goods and services in these companies first. This can impact their share price which may start to fall.

Non-cyclical stocks are typically less sensitive to market volatility or economic downturns. Goods and services provided by a non-cyclical company may be considered essential or in demand regardless of how well the economy is going. For example, companies in the healthcare, supermarkets or utilities sector. Non-cyclical stocks may therefore be referred to as “defensive stocks”.

Investing in cyclical stocks can be volatile as it can be difficult to predict the direction of the economy and when it may change. However, they can also provide the potential for high returns during periods of increased economic growth. Therefore, at Perpetual, we aim to construct a well-balanced portfolio that is diversified across industry sectors and countries. This may include cyclical and non-cyclical stocks.

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