

Business Cycle Investing: Relevance and the Mutual Fund Edge

A business cycle refers to the natural pattern of expansion and contraction in an economy that plays out over time. It is marked by alternating phases of growth, slowdown, recovery, and recession. Each of these phases has different characteristics. During expansion, economic activity rises, businesses invest and hire more, and consumer spending increases, while during downturns, demand weakens, investment slows, and unemployment rises.

These recurring fluctuations influence corporate earnings, interest rates, and stock markets. Business cycle investing involves identifying the current phase of the cycle and building a portfolio of stocks that is positioned to benefit from that stage of the cycle.

Business cycle investing is agnostic to investment styles, sectors, themes, and market caps, helping ensure a well-diversified portfolio. It allows investors to take exposure across sectors, themes, and company sizes, depending on where opportunities emerge at different stages of the cycle.

It follows a top-down approach where the investment process starts with first identifying the prevailing business cycle. During a growth phase, confidence among consumers and businesses is typically high. Companies plan expansion as plants operate close to full capacity. Greater visibility on sales growth and order flows encourages firms to hire more and undertake new capital expenditure. During this phase, discretionary spending also remains strong. In contrast, a slowdown or slump phase is marked by weaker



Shailendra Sharma,
Co- Founder, Claritas Wealth and
Distribution LLP

demand, idle capacity, lower capital expenditure, uncertain employment prospects, and subdued consumer spending.

These changing dynamics influence how different sectors perform. During periods of recovery and early expansion, cyclical sectors such as financials, consumer discretionary, and metals tend to do well, supported by improving business activity and consumer demand. In contrast, sectors such as pharmaceuticals, IT, and consumer staples typically lag during these phases. Their appeal increases when growth weakens and investors prioritize stability. Business cycle investing is not limited to sectors alone; it also seeks to identify broader investment themes that are likely to benefit from the prevailing phase of the business cycle.

Business cycle investing has become more relevant today as the global economic environment has grown more volatile. In earlier decades, cycles were supported by favourable conditions such

as low inflation, relatively stable geopolitical situations, and liquidity. These factors helped smooth economic fluctuations and supported steady growth. Today, the macroeconomic landscape looks very different. Inflation has become more persistent, geopolitical risks have intensified, and monetary policies have tightened across major economies. These changes have made economic cycles sharper and less predictable, increasing the importance of flexible and responsive investment strategies.

In such an environment, portfolios need to remain agile. As conditions evolve, investors must be prepared to shift exposure across sectors to limit downside risk and reduce volatility. Business cycle investing supports this flexibility. Business cycle investing may also involve holding a modest cash allocation. This provides flexibility to capitalise on emerging opportunities as macroeconomic conditions shift and valuations become attractive.

For long-term investors, this framework offers a disciplined way to navigate changing market conditions without reacting to short-term fluctuations. By focusing on economic trends and sector dynamics, business cycle investing helps to align with long-term growth drivers and improve the potential for consistent, risk-adjusted returns over time.

In this context, business cycle mutual funds provide an efficient and practical way to implement this strategy. Through professional management, diversification, and timely sector rotation, they serve as an effective vehicle for navigating today's more volatile and rapidly evolving global environment.