

Why cycles matter in an investing framework



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Identifying where an asset class is positioned in the economic cycle is like doing a good chunk of investing homework.

Looking at the position of an asset class in an economic cycle is the starting point of all investing. Each asset has its own unique position, and they all behave differently depending on the business environment. We have also seen price actions

overextending in the past on the upside or down.

Hence, identifying where the asset class is positioned in the cycle and focusing on what is likely to work is doing a good chunk of investing homework.

To elaborate further, let's look at various styles of investing. There are periods when moats work, sometimes growth surges ahead, times when value investing is in top form and others when fixed income is doing well. And vice versa. But the rewards can be an icing, when you bet against this overextension.

Buffett has often used this strategy. He sits on cash for long periods, famously waited for the 2008 crisis to peak, and invested Rs 60,000 crore in one go and the bottom of the market. In 2011-12, when the cycle overshot again on the downside, he wagered another Rs one lakh crore. Of course, Buffet does have the cushion of waiting for the right time because he runs the biggest closed-end fund.

With an open-end fund, investing is different as one has to be invested all the time. At the same time, Warren's philosophy underscores one point - that cycles matter. And we have to be mindful of these cycles, and hence have to be careful in choosing the right patterns of investing that matches the business environment of the hour.

If you look back in 2007, a moat style of investing did not do too well. Back then, infrastructure companies did not have any moats. In my experience as a fund manager, the period between 2004 and 2007, saw growth without quality do a little better. In that period, using another investing style meant that investing results would not have been good.

Post 2007, there was a 6-7 year period where moat-based strategies outperformed everything else. Hence, creating the right framework of using the apt strategies at that opportune time is a more prudent way of going about investing. Different strategies work in different

time frames.

In the US in 60s and 70s, moats were sought after as a strategy. Moats were high quality stocks with PEs of 50-70 times earnings. Circumstances have changed these days. Moats have shown they can disappear.

US retailing giant, Walmart, met many standard tests of moat investing. But over the last few years, its moat has proved to be brittle and Amazon seems to have just taken off in market cap relative to Walmart.

Buffett was also of the opinion for some time now that print media had a moat. Now we see that print media has lost its moat. Retailing has lost its moat. Even with the scale and size of Walmart.

In India too, the shift has been apparent. In 2015, Indian tech was the incumbent with a much superior moat. Now that moat has shrunk because of digital shifts in technology towards other forms of development. So, clearly it doesn't appear that the technological moat company is from India today, while five years back there were hardly any questions that a tech disruptor was going to be an Indian company.

I am of the opinion that we cannot convert investing into formulas. I guess that's why Buffett believes that it's safer to buy a toothpaste stock because toothpastes, soaps and detergents are things which haven't changed for 50-100 years. He has been pretty reluctant to look at things which can be affected more by technology.

But I am sure that when he was invested in the print media, he never realized that some other sector technology could go and disrupt what he thought was a beautiful moat-based company.

So, I think the advent of technology has kind of shaken up the moats of many sectors. In 2007, we did not think that retailing as a story in India could get affected by technology. Or whether there was a connection between technology and retailing, other than goods tracking software. But now retailing is so much heavily dependent on technology.

Also in 2007, the moats of sectors like pharma and consumption were overlooked for growth without quality. Those days, commodities and infrastructure stocks were ruling the bourses.

In 2007, pharma had huge margin of safety because the price was much lower. Hence strategy keeps changing and investing is all about identifying and knowing where you are in this particular cycle, be it of an asset class or within an asset class, a sector.

In investing, one might not look good sometimes because you may have entered a cycle too early. But investing is not about looking good in the short run. Results will come over time if your broad framework is right; backed with a conviction of weathering and holding through cyclical shifts. Over the long run, this framework will reward well.

Gold enters the storybook stage

MARKETS

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After surging for years, the price of gold has entered the realm where storytelling drives its price. Breaking free of the fundamental forces that long explained its ups and downs, it is now rising on tales of global risk and uncertainty – which make this era feel to some observers like the gold rush of the 1970s.

Gold has long been seen as a safe haven because its price has kept pace with the rate of inflation for centuries, albeit punctuated by busts and booms. The booms tended to come in periods when real interest rates declined. As returns fell on money held in savings accounts or bonds, people tended to move their wealth into gold, which offers no yield but at least can rise in price.

That pattern started to change in a material way in 2023. Real interest rates were high compared to the recent past and rising, but gold prices began to take off. The main driver was a huge increase in purchases by central banks looking to shift their holdings away from the dollar, which the US weaponised for use in sanctions against Russia over the Ukraine war. The price of gold has skyrocketed since then, but what I once called the “anti-dollar revolution led by foreign central banks” can no longer explain it.

Over the past year, the pace of central bank purchases has slowed down. Jewellery demand has plunged as consumers balk at the high prices. Instead, demand has exploded from investors in all the major markets from the US to India and the UK. The investor share of gold purchases doubled last year to 35 per cent worldwide, led by torrential flows into gold ETFs. Nowhere is the fervour more intense than in China, where retail “auntie” investors have jumped head-first into the buying spree.

In short, gold is being driven largely by financial demand, and this shift is

upending the traditional understanding of how to calculate its value. The models long used to explain the price of gold, which include real bond yields and inflation expectations, have all broken down.

Relative to inflation, for example, the price of gold is now five standard deviations above its historical norm; put plainly, this is freakishly unusual behaviour. Meanwhile, a model developed by

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the World Gold Council attributes more than 80 per cent of gold's latest gains to “risk and uncertainty” or “residuals”. That’s another way of saying scary stories and “we have no idea”.

The story gold bulls are telling is that the current state of the world evokes the backdrops of past gold super cycles – meaning long and strong bull markets like those of the 2000s and, especially,

the 1970s. But inflation today is nowhere near the double-digit levels of the Jimmy Carter era. And it is hard to argue that uncertainties such as Donald Trump, tariffs and Ukraine are objectively more disconcerting than, say, oil embargoes, Vietnam and the Iran hostage crisis were back then.

Another popular argument is that gold continues to thrive as a haven from “dollar debasement”. But if that is so, why have other alternatives to the dollar such as bitcoin been tanking, and why have other dollar assets like US stocks and bonds been holding up?

Gold also broke free of fundamentals in the later stages of its 1970s boom. By the end of that decade, gold was selling for \$500 per ounce, or about 2.5 times its implied value based on real interest rates. Today the price of gold is five times this implied or “fair” value, at nearly \$5,000 per ounce.

Nonetheless, it is difficult to see what might break this momentum. Liquidity remains plentiful worldwide, so a lot of people are looking for more places to put money. Even after the recent buying sprees, investors hold relatively little

gold in their portfolios. The 1970s super cycle ended only when the Federal Reserve began to aggressively raise rates to fight inflation, and there is little chance of that happening now.

Gold bugs therefore say the yellow metal has plenty of room to rise, and they may be right. So far, in inflation-adjusted terms, it is up more than three-fold over the past 10 years. But that’s not much relative to its 12-fold rise during the 1970s. And while prices may appear to have risen parabolically in recent months, the rise has been much less spectacular than the spike in the final stage of the 1970s boom, when gold doubled in price over two months.

While I have been bullish on gold for many years, I’m more agnostic now. In a market divorced from fundamentals and driven by an increasing number of random stories, it is hard to know which narrative is for real and will hold. If you want to buy more gold, you just gotta believe.

The writer is chair of Rockefeller International. His latest book is ‘What Went Wrong With Capitalism’

Smallcaps: A silver lining

Indian equity markets present a striking paradox. Mega companies are struggling with their businesses as if India is in a recession, yet their stock prices remain firm. Scores of small firms are doing extremely well, as if the Indian economy is growing at 10 per cent or more, but their stock prices are languishing. How will this paradox be resolved? In my view, we may now see an outperformance by quality smallcap stocks and possibly continued stagnation in largecap stocks.

The Indian equity markets have underperformed most global markets since the peak in September 2024, after an 18-month bull run. During this run, the bulls refused to be reined in even by the underwhelming performance of the ruling party in the June 2024 general elections. After a day of shock at the results, the markets resumed their upward march — until headwinds started emerging later in 2024, followed by an 18-month phase of underperformance. However, if you look at the large companies in the Nifty or CNX 500, this underperformance may not be obvious. While the Nifty was down 2 per cent between early September 2024 and late January 2026, the CNX 500 was down 5 per cent. But over the same period, the Nifty microcap index was down 17 per cent. The median returns were far worse.

Some of the decline in small caps was justified. Many of them had become too expensive, carrying very high growth expectations aided by strong fund flows. So when the economic headwinds started blowing in 2025, expensive growth stocks were sold. These headwinds came from three sources. First, there was reduced government capex — the principal driver of the 2023-24 bull market — which was initially blamed on the 2024 elections but continued well into the fol-

lowing year. Second, India was hit with punitive tariffs by the United States in 2025. Third, there was a slowdown in domestic consumption due to high taxes and slow wage growth.

Spooked by this barrage of negative news, foreign institutional investors (FIIs) sold heavily. Net outflow was nearly \$23 billion in 2025 and January 2026 combined. The problem during such phases of selling is that investors tend to be indiscriminate; good stocks get punished along with the bad ones. Coinciding with continuous FII selling, the Reserve Bank of India allowed the rupee to weaken, possibly to support exporters. Since the Indian equity markets have been highly correlated with the value of the rupee, this made matters worse. Last year turned out to be the worst performance for the Indian markets in over three decades; it underperformed other emerging markets by nearly 40 per cent. In such a situation, “buyer’s strike” sets in, making markets brittle. So the market can fall sharply for no clear reason, as we saw last Thursday, when the Sensex dropped 1,400 points.

Is there a silver lining to any of this?

There is. The December quarter has given us data that is suddenly very positive. Continuing with the paradoxical price behaviour of largecap stocks (resilient) and smallcap stocks (wilting), we have just witnessed another weak quarter for Nifty 50 stocks and an excellent quarter for Nifty smallcap and microcap stocks. Sales of the Nifty 50 companies, which include megacap firms, were up 10 per cent, but they recorded zero per cent operating profit growth and only 1 per cent net profit growth. The broader CNX 500 companies recorded 11 per cent sales growth and 8 per cent growth

each in operating profit and net profit, similar to BSE 250 largecap and midcap stocks (11 per cent sales growth and 7 per cent profit growth).

However, contrary to conventional wisdom — which assumes that smaller companies do worse under economic stress because larger ones have more resources to withstand headwinds — they have done very well. The sales growth of the Nifty microcap index companies was 12 per cent, operating profit growth 13 per cent, and net profit growth 24 per cent. The best-performing group was the Nifty Smallcap 250, which recorded sales growth of 11 cent, strong operating profit growth of 22 per cent, and a stunning net profit growth rate of 38 per cent.

I do not know whether this will lead to a new bull market, especially in smallcap stocks, but we are probably in a situation opposite to the one we were in September 2024. Valuations are now very reasonable for many small but fast-growing companies. Their fundamentals have improved, as mentioned above. Of the 1,000 companies we track, about 200 have reported operating profit growth of 30 per cent, which is the highest number since the June quarter of 2023. There are also a few economic indicators that support this view.

Government capital expenditure (capex) has rebounded to budgeted levels, and there is some pickup in private-sector capex as well if we go by the corporate data. The commercial-vehicle segment is doing very well, away bills have hit new highs, and growth in bank credit remains strong. Improving fundamentals of quality smallcaps, combined with falling stock prices, make for an interesting combination. Keep your fingers crossed.

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