

We talk about cycles all the time. We've outlined the multi-decade innovation and deployment cycle. We've talked about housing cycles, risk cycles, and economic cycles. It's probably a good bet to say that 80% of anything we've written is about some kind of cycle.

"So what in the world is a cycle anyway, and why is it the only thing these Doxa guys talk about?"

1. Humans are **remarkably** good at adapting. Just look at how humanity has adapted over the past 12 months. This trait makes forecasting future outcomes very difficult.
2. People's idea of their future is most often an extrapolation of their past.

Now combine these two things. We adapt to our surroundings, then extrapolate those surroundings out into the future. When outside variables mess up our surroundings, we adapt and start the whole thing over again. Add in some groupthink and one big cycle is formed.

One of investing's "superpowers" is to see the world through cycles instead of linear extrapolations. Yes of course every cycle is different. Many variables can change or modify cycles at any time; there are even cycles within the cycle. All of that is really important to understand – *we outline those details for the [current cycle here](#)* – but for now I'll just give you a quick cheat code to seeing an economic cycle in real time: search "u3 fred" on Google and click the first link. You'll see the chart below, which is the US unemployment rate.



It's easy to see 4 different cycles over the past 4 decades in this chart. Unemployment shoots up (recession), which ends one cycle and begins another. Each one of these cycles had different causes, consequences, and magnitudes, but all else equal you're looking at the 4 business cycles that have defined the last 40 years. And remember, hindsight is 20/20. At any given point no one really knows if that line is going to go up or down, but again that's why the details matter.

So where are we now? We're at the end of year one of a multi-year cycle.

The pandemic created a recession unlike any other, but that doesn't mean that the playbook is all that different from prior cycles. Unemployment still went up very fast, and now is coming down very fast. We don't know how long this cycle will last, or how low unemployment will ultimately go – but it seems safe to say we are closer to the beginning than the end. *(Another plug for our [December note](#) –showing why COVID-19 started a new cycle and how this one is different from our recent past.)*

Why are cycles so important?

Unfortunately knowing where we are in a business cycle doesn't telegraph where to invest. What works in one may not work in another – like tech in the 2010s (*best*) vs. tech in the 2000s (*worst*). However, it can help us frame our expectations around the future growth of the economy. At the beginning of the cycle, we can expect a pretty good runway of growth and look through the bumps along the way. On the other hand, when it feels like the cycle is coming to a close we get more cautious and can be defensive.

At Doxa, applying this is pretty straightforward. We build a portfolio made up of “cycle stocks” and “core stocks”. Cycle stocks are businesses dependent on a good growth backdrop (or defensive ones that perform better in a not-so-great backdrop). In the early-to-mid cycle where we find ourselves today, these are primed to do well. Think of a company that makes asphalt shingles. There's nothing unique about shingles per se, but in a great housing environment and with high building activity the roofing business is on fire.

The core stocks are elite businesses that are benefitting from big secular shifts in the economy – take the big electrification shift for example. A company that once made tire pressure sensors has now had new markets open to them as machinery and transportation have become “smart-powered” and all types of sensors are in constant demand. These secular businesses compound earnings year after year, and can be in the core for as long as the secular shift is in place.

In just one sentence, we invest in the cycle and we invest through the cycle.

Some extra closing thoughts on the current cycle we find ourselves in:

1. Some evidence is showing that we are moving into mid-cycle. Because of the “shutdown” nature of the COVID-19 recession, it appears that this cycle is progressing much faster than the last one.
2. How long will it last? There is still no good read at this point. We could see it being short and hot. We could also see a 90s-esque cycle of longer but very overheated.
3. Housing is very strong. Home prices will likely moderate, but don't expect the underlying fundamentals to weaken for a while.

4. Remember: great companies are very rarely cheap. Have patience in waiting for them **and** holding them. Patience is the scarcest commodity in markets – let it work to your advantage.

BONUS: Identifying cycles or a big secular trend is only half of the battle in managing portfolios. Disciplined risk management is the other half.

But what does that mean really?

It's a set of principles that reinforces good habits. Our principles: use compounding, vigorous planning, minimize selling. When price volatility comes along (like during COVID-19 last year), it's through this discipline that we have confidence in our portfolios. In turn, those high-quality portfolios make it easier to maintain discipline in adverse times.

At the end of the day, everything's a cycle.

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