Selling at Cyclical Peaks

## Description

For investors who follow the market and have long track records of investing, the difference between a cyclical stock and a defensive stock is much likely understood through experience. The preference for most new investors in addition to lower-risk investors is to purchase defensive stocks instead of cyclical stocks.



The difference between the two categories is the variation of revenues and profits during the various periods of the economic cycle, which, for cyclical companies, is very high. Defensive companies have much more consistent revenues and earnings throughout all periods. Companies like grocery stores or power companies are some of the best examples of defensive securities as consumers will continue to purchase an equal amount of the company's products or services during booming economic cycles just as in recessions.

Cyclical companies, however, will experience a very large increase in revenues and earnings during prosperous economic times, which leads to a much more volatile stock price. Although the long-term returns can be much higher for cyclical companies, most investors are keenly aware that this is not always the case. Depending on the period investors choose to evaluate, many of these more lucrative, high-flying securities may look very attractive during good times, but they tend to pull back significantly more than average during economic slowdowns.

What often begins as an appropriate allocation to any one stock or industry at the beginning of a market cycle often grows quite substantially in market value as the economy expands and cyclical stocks begin to fire on all cylinders. The action taken by the investor, which should most often be a trimming of the position, often does not happen. Instead, many investors either purchase more shares of a company performing very well or simply hold the shares they currently own. The position grows further.

One of the biggest challenges investors face is deciding when to sell out of an investment. The good news is that for cyclical securities, that part of the investment process is a little easier. Unlike defensive companies, which are typically rock solid year after year, cyclical companies will turn every time thereis a slowdown. Recessions happen on average every seven years.

Enter **BRP Inc.** (TSX:DOO), which has had an incredible run. In the business of manufacturing recreational vehicles, such as ATVs and Ski-Doos, the company has performed fantastically as of late. Earnings per share increased from $0.75 for the year ended January 31, 2016, to $2.76 for fiscal 2017. As a cyclical company, the good news for investors has been the increase in share price by over 85% in a one-year period.

As the expression goes: “When it rains, it pours.”

Given the large uptick in earnings and the gap between today and the last recession, investors need to keep in mind the potential is found by looking into the future and not in the past. For most cyclical companies (including BRP Inc.), there may be no better time to sell than once earnings begin trouncing expectations.

**CATEGORY**

1. Investing



**TICKERS GLOBAL**

1. TSX:DOO (BRP Inc.)

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**Category**

1. Investing

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ryangoldsman