How to Make Money From Cyclical Stocks

Description

The stock market is forward looking, where stock prices reflect the market participant's expectations with the company. Understanding the characteristics of a stock will help devise smart [investing strategies](). One such type is a cyclical stock, which moves in tandem with the economy and business cycles.

The art of trading in cyclical stocks

Cyclical stocks see significant demand after a period of weakness. While the entire stock market is about timing, it is comparatively easier to gauge the upturn and downturn of cyclical stocks. How do you make money from cyclical stocks?

- First, look at the interest rate, consumer spending, and economic and industry growth forecast to understand the market trend.
- Then choose an industry that is due for a revival.
- Within that industry, choose companies that are well positioned to tap the growth trend.
- Hold cyclical stocks throughout the growth cycle and sell when you see demand slowing.

Large companies are safer but give lower growth, while small companies are riskier but give handsome rewards if they succeed.

As the stock market is forward looking, a good investment strategy is to buy cyclical stocks at the start of economic revival and sell ahead of a slowdown. Here are four cyclical stocks to buy ahead of recovery.

Suncor

The International Monetary Fund expects Canada's gross domestic product (GDP) to grow 6.3% in 2021 and 4.5% in 2022, higher than its average GDP growth rate of around 1.8-3%. The forecast shows a slowdown in economic growth, but this is a wave of recovery. The 2021 growth forecast is high because the 2020 base year is weak.

Canada is the third-largest oil reserve, and oil forms a major part of its economy. **Suncor Energy** (TSX:SU)(NYSE:SU) is Canada's largest integrated oil company, providing everything from extraction, refining, transmitting oil, and retailing fuel. Suncor stock doubled in the first phase of recovery (November 2020 to mid-June 2021). However, the stock dipped 25% since then, as oil prices fell. But the oil industry is in a cyclical uptrend, as the reopening of international borders will kick in pent-up travel demand.

Higher demand will increase cash flow from Suncor's retail segment and offset the extra cost of the carbon-emission-control initiative. This is the right time to buy the stock before the upturn is reflected in the stock price.

Transportation stocks

As I said before, there is pent-up demand for air travel, and most of this demand is from vacationers. People are tired of staying home and need a break. Hence, there is demand from vacationers who delayed their holiday plans and from those who want a break from staying home. But the third wave stalled the recovery of transportation stocks.

Air Canada (TSX:AC) is the largest international airline in Canada and the key beneficiary of the pent-up demand. Then there is international tour operator **Transat** (TSX:TRZ) among other beneficiaries. Until February, AC was going to acquire Transat but backed out, because it did not receive the European regulator's approval in the given time frame. Now, the two companies are operating separately. Both the companies have government bailouts. They are well placed to address the pent-up demand.

Magna stock

The automotive industry is currently nearing the end of its cyclical downturn. First, the pandemic shut down factories of the automaker and automotive components. Now the industry is facing a chip supply shortage. However, the semiconductor industry is working on it, and the issue should be resolved towards the second half of 2022.

There is huge pent-up demand for electric vehicles (EVs), and **Magna International** (TSX:MG)(NYSE:MGA) is well placed to tap this growth. It serves 23 of the top 25 EV makers, supplying automotive components to some and manufacturing cars for some. Whichever auto company takes the market share, Magna will benefit as a supplier.

Foolish takeaway

The above four stocks are at the cusp of a growth cycle. But all growth is too risky. It is better to hedge your portfolio with some defensive stocks, like logistics and grocery, that are not impacted by economic cycles. This way, you can grow your returns in an economic upturn and reduce your risk in a downturn.

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