CYCLICALS

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JENGA IP BRIEFINGS

A 2025 Global Equities Cyclical Review

Businesses, industries and markets experience cycles of good and bad times driven by various factors, from economic changes, technology and innovation to the human nature of greed and fear. During downturns, investors generally become pessimistic about short-term prospects, leading to broad sell-offs. Most times, these sell-offs are justified when the challenges are structural, but in some situations, the challenges faced by companies are cyclical, leading to an opportunity for investors willing to have a longer-term view with a focus on fundamentals recovery.

The purpose of this report is not to share stock picks but rather to highlight companies and industries experiencing a downturn. Our role as fundamental investors is to differentiate structural decliners from cyclical companies and search for companies with superior quality characteristics relative to their peers that may benefit from a sector-wide upturn in the future.

“Every industry and company faces some cycle, whether economic, sentiment-driven or technological disruption”

- Jenga Investment Partners

From our research below on the cyclical downturn, it was clear that certain industries and themes are experiencing a severe downturn, such as biotechnology, lithium, solar and the broader renewables theme, sports apparel, shipping, and alcoholic beverages. Some of these industries include companies that were once hot stocks, highlighting an important lesson on valuation and momentum. Despite the demand for solar and lithium still growing into 2023 and 2024, more than half of all listed companies in the respective themes were among the underperformers. We explore this and other cyclical themes.

We conclude this report with a 20-company watchlist of companies from the screen above that may have the potential to rebound should their industry conditions improve. Note that Jenga IP only holds a position in one of these companies (Kering), but we have included some, like Estee Lauder, Grupo Bimbo, and Paypal, into our 2025 research shortlist. Also, we are unlikely to have positions in Autobio Diagnostics and Genmab, as both are outside our circle of competence.

Our primary tool for determining these cyclical companies is their share price performance over the trailing calendar years: a 30% decline in 2024, a 40% decline in 2023 - 2024, a 50% decline in 2022 - 2024, or a 60% decline in 2021 - 2024. We also include minimum filters of companies with a positive operating profit margin and a return on equity of at least 6% in any of the past four years. Before we dive into the distribution of these companies, it's crucial we break down what we mean by cyclicals and their four key groups.

Cyclical groups

- Commodity-linked cyclicals are companies like oil and gas refiners, metal and mining companies, or agricultural companies that sell products with a set commodity price.
- Economic-linked cyclicals cyclicals are companies whose production volume is highly correlated with the broader economy, such as airlines, cruise lines, and auto manufacturers.
- Broken cyclicals are previous growth companies (>15% revenue growth CAGR) experiencing company-specific challenges, typically caused by industry trends, technological changes, or supply shocks. A recent example is PayPal.
- Turnarounds, although not pure cyclicals, can be broken compounders, cyclicals or stalwarts that have been challenged for an extended period (>3 years). A recent example of a successful turnaround is Rolls-Royce Holdings.

The cyclical downturn screen

The screen filters utilised in this research had the following parameters;

- Share price performance declined by -30% in 2024, -40% between 2023 - 2024, -50% between 2022 - 2024 or -60% between 2021 - 2024
- EBIT margin positive during any year between 2021 and 2024
- A minimum return on capital during any year between 2021 and 2024
- Minimum market capitalisation of $1 billion

Banks and REITs were not included to the filter.

Among the 8,954 globally listed companies with a market cap above $1 billion, 752 companies met the requirements, and in the table on the next page, we share a breakdown of these companies by industry and highlight the sub-sectors that contributed to the underperformers. Next, we assess each industry except real estates and financials as there were no material trends.

Did you know?

7% of the listed 8,950+ companies above $1 billion market cap declined by more than 30% in 2024. The largest among these companies were Samsung Electronics, PDD Holdings, Boeing Company, Nike and Intel Corporation

Industry	Number of underperformers	As % of total number of underperformers	As % of broader market	Sub-sectors contributing to underperformance
Consumer Staples	62	8.2%	7.2%	Beverages
Consumer discretionary	101	13.4%	11.6%	Sports apparel, marketplaces, luxury
Industrials	109	14.5%	20.0%	Renewables, electricals, professional services, shipping
Materials	134	17.8%	11.0%	Lithium, batteries, iron ore, platinum
Utilities	12	1.6%	4.6%	Solar
Energy	28	3.7%	4.4%	Gas, jet fuel
Real estate[1]	7	0.9%	3.4%	
Financials[1]	19	2.5%	8.9%	Payments
Healthcare	119	15.8%	10.0%	Diagnostics tools, healthcare platforms, gene therapy, biotech tools
Information technology	125	16.6%	13.7%	Solar, IT services
Communication services	36	4.8%	5.2%	Telecommunication

1 - REITs and banks were not included into our screen which underestimates the number of companies that underperformed in Real Estate and Financials industries (GICS)

The consumer space - consumer staples (62) and consumer discretionary (101)

2024 was a particularly challenging year for both consumer staples and consumer discretionary which is evident in the fact both industries were two of the four industries that were overrepresented relative to number of listed companies. Staples in particular are generally among the less cyclical industries but this was not the case in 2024. We believe this is due to three key reasons;

- Aggressive price hikes: To cope with the pandemic-induced supply chain issues, several staples businesses aggressively raised prices, overestimating their pricing power relative to consumer disposable income. In response, categories like cosmetics and beverages saw a drop in demand as these consumers responded to pricier products.

- Chinese economic challenges: 30 of the 62 companies in staples were from China, despite China representing only 22% of all listed consumer staples companies. The slowdown in the Chinese economy, fuelled by the real estate market bubble, caused a broad sell-off across the sub-sector. Some of these Chinese companies were also trading at highly overvalued multiples; the largest Chinese company, Foshan Haitian Flavouring and Food was valued at 120x PE at the end of 2020!

- GLP-1 drugs: In the second half of the year, several consumer food companies began noticing volume pressure from customers who use GLP-1 drugs for weight loss. Of the three issues, this seems to be the most structural.

Consumer discretionary

Unlike consumer staples, consumer discretionary was not about pricing power issues but volume and heightened competition among companies. A good example were the internet marketplaces ranging from the big three Chinese e-commerce sites to Western marketplaces like Zalando and Etsy, all flagging more competition from newer sites like Temu and Shein. Outside marketplaces, the apparel space contributed to the underperformers as 16 companies were from this sub-sector, led by Nike, Puma and Li Ning. Like internet marketplaces, newcomers like On Running and Hoka (owned by US-listed Deckers Outdoor) are challenging the more established players.

Another sub-sector that contributed to consumer discretionary was the luxury industry. The luxury industry had benefitted from the economic boom in China over the past few years, and being an economic-linked sub-sector, luxury goods tend to reflect the economic challenges.

Jenga IP Consumer Perspectives

- Some consumer sub-sectors have higher barriers to entry and are more oligopolistic than others and we believe it's important to focus on these companies during downturns.
- We are leaning more towards the consumer staples such as Grupo Bimbo, Pernod Ricard and Estee Lauder (the latter going through a turnaround)
- Each of these are businesses that can achieve high return on capital should their respective cycles revert. They also operate in global markets which provides further growth opportunities for the future.

Information technology (125) and communication services (36)

We certainly didn't expect to see IT among the underperformers given how well the industry had performed in the past year. 16.6% (125 companies) of all underperformers were from IT alone, above its 13.3% representation across global markets and two key themes contributed to the underperformance.

Solar: 25 of the 125 companies (20%) companies were solar-related companies despite there being less than 50 listed solar companies. This means more than half of all solar companies underperformed. Solar is generally a commodity-linked cyclical as the industry, although growing, is largely driven by solar PV prices, which experienced a boom period in the trailing four years. During this downturn, we can expect consolidation and potential bankruptcies across the sector, so it's vital to focus on companies with both the lowest cost of production and those with better balance sheets to weather the cyclical challenges.

- China: 62 of the 125 (50%) companies were Chinese companies within IT split between the solar and non-solar companies. In the latter segment, we noticed a more sentiment-driven cycle shift where expectations transitioned from very high to just high valuation expectations. Several of these companies were valued at lofty multiples, above 60x earnings. Today, most have declined from 60x+ to 30-40x their earnings. For example, the largest two of these, Will Semiconductor and Goertek, fell from an average P/E of 66x to 41x in the past three years.

Communication services

Communication services haven't traditionally been a good area to search for cyclical companies as you tend to have two extremes outside advertising-based businesses: (1) stable companies like telecommunication and TV stations and (2) high-churn and volatile businesses like gaming studios and media consulting companies. We notice a similar split when we examine the underperformers from the sub-sector. The former tended to be companies with debt and leverage issues, like BCE in Canada, Sirius XM, Altice USA and Paramount. On average, these companies use half of their operating profits to service their interest payments, which causes problems in an environment where interest rates increase.

The latter group of more volatile businesses reported a higher churn than expected, leading to less advertising revenue and sales, including gaming companies like Ubisoft and NCSoft and social sites like Match Group, Weibo, and Kuaishou. Beyond their high churn, increased competition with big tech companies has significantly impacted their near-term prospects, and it is important investors reassess what a fair multiple might be for these companies.

Jenga IP TMT Perspectives

- Several of these businesses are outside our circle of competence and for those within, our most important factor is durability and ability to withstand continued pressure from big tech and broader technological shifts.
- Here, we see a potential case for Samsung Electronics, Sirius XM, and, to a lesser extent, Match Group. To compensate for the several challenges, we would only pay single-digit multiples if we ever purchase shares in these companies.

Industrials (109), utilities (12) and real estate (7)

Industrials will broadly mirror the economic environment as these companies support consumption and productivity, from infrastructure and transportation companies to capital goods and professional services. Due to this correlation, it's not a surprise that we see a close correlation between countries experiencing headwinds like Mexico and China with companies in the industrial cyclicals.

As we saw in IT, the renewables value chain (solar PV manufacturers) broadly underperformed and here, renewable sub-sectors like battery and inverter manufacturers largely contributed to the industrial underperformers. During boom times, these companies earn a lower return on capital than the PV manufacturers but tend to be more resilient during slowdowns in renewables. Companies related to the Chinese construction slowdown similarly underperformed, such as Sany Heavy. Outside China, we noticed an overrepresentation of business process outsourcing (BPO) companies like Teleperformance and shipping transport companies. Both had boomed during the pandemic but now face differing issues, with the BPO industry seeing technological disruption from AI while the shipping companies saw a sharp reduction in freight prices as supply chain disruptions improved.

Utilities

For utilities to underperform, something extraordinary typically has to happen and this was the case with a few of them. An example was Uniper in Germany, which saw its prospects evaporate from the effects of the Russia-Ukraine war and required a bail-out from the German government. In the newer economy utilities, which were mainly solar utilities, most of these businesses had prioritised growth over quality balance sheets and then faced several challenges with the drop in the broader solar and renewables market.

We still see solar as part of the overall energy value chain, and we wouldn't be surprised if some of these companies either recovered some lost ground or became takeover candidates from larger utility businesses.

Jenga IP Industrials Perspectives

- Solar utilities P/E ratios have contracted from 30-40x in 2021 to around 10x earnings today. Given the regulatory challenges, we prefer companies in countries like Spain and Brazil with clearer solar renewable strategies.
- In industrials, we prefer diversified groups like Grupo Carso (Mexico), which can reallocate capital across its various divisions to better withstand economic downturns.
- There's a steep contrast between the larger battery companies and those that underperformed. It seems that bigger companies hold the profits due to economies of scale. With reduced global subsidies and government support, this will likely become even more critical when selecting winners in this downturn.

Materials (134) and energy (28)

Investors can rely on commodity prices experiencing a downturn in materials and energy industries to indicate potential underperformers. Most decliners were commodity companies that experienced a price contraction, such as iron ore, lithium, platinum, and steel. Each of these commodities has specific long-term demand and supply drivers. For lithium, this is the growth in clean energy and electric vehicles, while its supply curve is largely driven by investments from Chinese refiners (65% of global processing), Australia and South American countries like Chile and Argentina. With iron ore, 98% of its use case is steel production, so if steel production deteriorates, iron ore prices are likely to follow.

Over the long term, commodities trend towards oligopolistic markets driven by a handful of big players, typically constrained by geographic factors. Hence, newer economy commodities like lithium haven't fully matured, and 30 (22%) of all materials companies were lithium-related companies, with 20 of them coming from China alone.

Like materials, energy companies tend to follow their underlying commodity prices, and in the industry, most underperformers were gas-related energy producers. Gas prices experienced a sharp drop after the initial spike in 2021, further amplified by the Ukraine-Russia war. There was also a noticeable presence of natural gas companies operating in the Gulf of Mexico region, such as Talos Energy, Kosmos Energy, and Valaris.

"Several companies operating in the Gulf of Mexico like Talos Energy, Valarais and Kosmos Energy were among the underperformers"

Image (left): Talos Energy offshore operations

For commodity companies, the most important factor over the long term is the balance between supply and demand. We have found it better to focus on materials with growing demand over the long term or those with oligopolistic market structures controlled by a few countries and companies like platinum and iron ore. In lithium, any recovery will likely be led by either Chilean companies with a low cost of production or larger businesses operating across its value chain (China). We want to see more consolidation before expecting any upturn in the lithium market.

Jenga IP Materials Perspectives

- We generally prefer commodities with high geographical barriers to entry and markets concentrated in few hands. We also watch capital allocation closely to understand how management might behave through the cycle. Some iron ore cyclicals like Kumba Iron Ore in South Africa and Fortescue Metals (in Australia)

- We also flag commodity companies exposed to green energy use cases like Neste Oyj, a global leader in renewable diesel

Healthcare (119 companies)

Healthcare has broadly been the worst-performing industry across markets, with the MSCI Healthcare index returning just 0.2% per year versus 6.8% for the MSCI World over the past three years. Much of this underperformance can be attributed to the reversal of initial COVID-19 beneficiaries in sub-sectors like biotechnology and life science tools. Both sub-sectors represented 40% (48/119 companies) of the underperformers led by BioNTech, one of the vaccine manufacturers.

Beyond the pandemic reversal theme, another key trend has been the multiples contraction for many healthcare companies, similar to what we saw across information technology. Almost half of all companies that underperformed this year were valued above 40x earnings before the pandemic. Japanese healthcare platforms like JMDC and M3 reached sky-high valuations of above 100x earnings, while several Chinese companies like Aier Eye Hospital and Zhejiang Wolwo Bio-Pharmaceutical approached the 100x P/E mark. Despite the sharp multiples drop, several of these businesses are still worth above 30x earnings, so we can expect another year of muted performance. The Chinese companies were the most significant single contributor to healthcare underperformers, representing half of all healthcare underperformers. Today, only 10 of the 61 Chinese underperformers are valued below 20x trailing earnings, which supports our view of these companies still being broadly expensive.

Healthcare cyclicals more often tend to be broken cyclicals; previous growth companies experiencing near-term shocks. When investing in these businesses, it's key to avoid what we call "one-hit wonders" which are businesses with single products or services that have a limited lifetime for customers.

Jenga IP Healthcare Perspectives

- Most of the higher-quality healthcare companies, like Pientzehuang and Wuxi AppTec, remain on the too-expensive list, which keeps us on the sidelines when we consider their fundamentals and the price we currently pay for their shares.
- The Chinese companies have an additional challenge beyond the pandemic with the ongoing crackdown on drug prices and bribery and this should be an important factor when assessing the risk/return.
- Within life sciences and biotechnology, we prefer those like Autobio Diagnostics (China) and Sartorius (France), which have a more straightforward path to recovery given their diversified applications.
- At a dividend yield of 6% and valued at 10x its potential forward earnings, Pfizer looks undervalued and is among our watchlisted companies from the cyclical drawdown screen.

The 80% drawdown

47 of the 752 companies experienced a share price decline of 80% during the four-year screening period, with healthcare (8 companies), industrials (7 companies) and financials (6 companies). From a thematic lens, there's a broad split across the 47 companies with no one overarching theme. That said, industries like IT services (Endava, TELUS), Brazilian financial services (StoneCo, PagSeguro) and the Chinese solar companies had more than one company, indicating a broader industry-wide downturn.

Concluding thoughts - Lessons on cyclicals

Our preference at Jenga IP is to invest in high-quality businesses with as minimal exposure to cyclicals. "Resilience to economic cycles" is one of our ten quality factors, and the more exposed a company is to economic cycles, the lower the valuation multiple we are willing to pay. However, we've learned from the past that taking advantage of these cycles can become great long-term investments, especially when these cyclical companies make up for their shortcomings in other quality factors like strong unit economics and balance sheets, high barriers to entry, volume growth through the cycle and pricing power.

Company	Industry	Country	Type	Cyclical notes
Alibaba	Consumer discretionary	China	Turnaround	The rise of Pinduoduo and the Chinese tech crackdown has weakened its growth prospects. Still, at 10x earnings and a cash-rich balance sheet, Alibaba has resources to cope with the ongoing storm
Autobio Diagnostics	Healthcare	China	Economy-linked	Like many Chinese healthcare and biotechnology companies, Autobio Diagnostics has seen its share price gains over the past 8 years evaporate after the healthcare crackdown. That said, Autobio is among the few profitable, well-funded and attractively priced Chinese healthcare companies.
Estee Lauder	Consumer staples	USA	Turnaround	The 3rd largest cosmetics brand has suffered from both challenges in China and self-inflicted issues. Investors would need to watch its turnaround plan and any operational improvements should lift shares.
Fortescue Metals	Materials	Australia	Commodity-linked	As one of the lowest cost iron ore miners, Fortescue Metals can whether further declines in the iron ore price as it did during the 2015 - 2016 price decline.
Genmab	Healthcare	Denmark	Broken	Genmab, like many of its healthcare peers, saw its valuations decline after the pandemic. However, Genmab's approach to biotech is less risky and attractive at a unit economics level. While outside our circle of competence, investors will need to monitor its royalty progress with Darzalex drug.
Grupo Bimbo	Consumer staples	Mexico	Economy-linked	At its current 13x forward P/E, the largest baking company in the world seems more undervalued than its international peers in food and packaged staples.
Grupo Carso	Industrials	Mexico	Economy-linked	The diversified Mexican group is among the few conglomerates with a track record of consistently earning an operating profit margin above 10%. Although not cheap at 14x forward earnings, the well-managed group can survive any external shocks in Mexico.
Kering	Consumer discretionary	France	Turnaround	Kering's more volatile brands haven't coped on par with its luxury peers, leading to a weakened balance sheet. Should Kering return to its pre-pandemic performance, shares could be valued at 12x.
Kumba Iron Ore	Materials	South Africa	Commodity-linked	Should Iron ore remain at its depressed prices, the South African iron ore leader can pay a dividend yield of 11% while maintaining its near debt free balance sheet and valued 7x earnings.
Neste Oyj	Energy	Finland	Commodity-linked	The collapse in D4 RIN prices has had a major impact on Neste's profitability. While we don't have a view on the commodity price, we always note when a growing commodity market leader can maintain profits after a market collapse.

Company	Industry	Country	Type	Cyclical notes
Nihon M&A	Financials	Japan	Economy-linked	Management recently purchased 6% of its outstanding shares, a first in years, indicating that they believe the Japanese leader in M&A SME services may be undervalued.
Nike	Consumer discretionary	USA	Turnaround	Missteps with its relationship with distributors, created room for newer rivals to win share. Although still at premium multiples, Nike's sentiment hasn't been this negative in many years.
Paycom Software	Industrials	USA	Broken	While it's unlikely that the HCM software company will ever return to growth rates of +25%, Paycom is among the few companies that have exhibited superior profitability in the past decade.
Paypal	Financials	USA	Broken	PayPal's focus on the consumer market rather than B2B proved costly in the wake of new payment entrants. While initial growth estimates seem unachievable, PayPal's new management shift could see the group win back some market share.
Pernod Ricard	Consumer staples	France	Economy-linked	At 14x forward P/E, the 2nd largest player in the oligopolistic international premium spirits markets will likely cope with broader pressures in beverages better than expected.
Pfizer	Healthcare	USA	Economy-linked	After generating record profits from its COVID-19 vaccine, Pfizer shares have lost half their value since 2021. The drop has attracted activist funds demanding better cost-cutting measures and more discipline with M&A. At 10x its forward earnings, shareholders have the additional benefit of its 6% dividend yield as they await its operational progress.
Samsung Electronics	Information technology	South Korea	Economy-linked	The slowdown in global electronics after a pandemic boom and misfirings in AI-related chips recently moved the conglomerate below 7x forward EV/EBIT.
Sirius XM	Communication services	USA	Turnaround	Compared to the other communication services businesses, Sirius XM has a better balance of customer retention and stickiness and its exposure to disruptive forces from big technology. Although not at a steep discount, its shares seem undervalued at 7x its potential 2025 earnings.
Solaria Energia	Utilities	Spain	Commodity-linked	Although solar continues to play a key role in the overall energy mix, renewable investors received a reality check on valuations. Heightened Capex intensity could negatively impact their balance sheets and pose a risk to their recovery.
Teleperformance	Industrials	France	Broken	AI likely has caused some structural challenges for the BPO industry, but Teleperformance will likely cope with these challenges better than others due to its global market leadership and more diversified business model. At potentially 6x of its 2025 earnings, Teleperformance is valued at its lowest-ever multiple since going public in 1992.

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