

Cycles, Corrections and Comebacks



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One of the biggest misconceptions in investing is the belief that markets move in a straight line. Markets rise, decline, recover and then repeat the process. Optimism eventually gives way to caution, excessive pessimism creates opportunities, and periods of exuberance are often followed by phases of correction. Understanding this rhythm may not enable investors to predict every turning point, but it can significantly improve the quality of decision-making over long periods.

Howard Marks in his book *Mastering the Market Cycle*, observes that cycles are inevitable and understanding them is of immense importance. Yet, he also cautions that cycles cannot be mastered with precision. No investor consistently identifies market tops and bottoms every time. What an understanding of cycles effectively offers is a perspective. It helps investors recognise extremes and aids in ensuring an investor does not become a prisoner of any prevailing sentiment.

Cycles Matter, But They Are Not Universal

While cycles are powerful, they are not the answer to everything. There will be periods when structural shifts reshape industries and alter conventional assumptions. One of the best examples of this is the evolution of the American technology sector. Over the last decade, companies such as Apple, Microsoft, Alphabet and Nvidia have been successful in creating enormous value. Traditional valuation frameworks have frequently struggled to explain the scale of wealth creation these companies have achieved because these businesses have benefited from structural changes in the way people live and work.

This raises an important question. Are these businesses cyclical or structural? The answer lies in recognising that both forces can coexist. Technology companies experience cyclical ups and downs, but the underlying trends driving them possess structural characteristics. Smartphones, cloud computing and artificial intelligence are no longer optional conveniences, as they have become deeply integrated into daily life. Their widespread adoption has changed the way economies function.

However, structural trends should not be confused with the absence of cycles. Every period of rapid growth carries the risk of excessive optimism. Investor optimism can sometimes run ahead of fundamentals, creating conditions for future corrections. Distinguishing between long-term structural change and short-term exuberance therefore becomes essential.

Structural Change Happens When Customer Needs Change

History offers several examples of businesses that failed because they became too attached to products and ignored the changing customer preferences. One of the examples of this phenomenon is the transition from scooters to motorcycles. Consumers increasingly sought better performance, fuel efficiency and modern aesthetics. Companies that focused only on preserving existing products failed to appreciate this broader shift in customer expectations.

A similar transformation occurred in telecommunications. Traditional telephone companies viewed themselves as providers of landline services. Consumers, however, valued convenience, portability and accessibility. Mobile phones fulfilled those needs and fundamentally altered the telecom industry. Both these examples demonstrate an important principle, which is, markets are influenced not only by cycles, but also by structural changes arising from evolving consumer behaviour. Investors need to recognise this difference because structural shifts can render conventional assumptions obsolete.

Different Asset Classes Follow Different Cycles

Once the importance of cycles is understood, another reality becomes apparent. Different asset classes move through different phases at different times. Historically, equities, precious metals and real estate rarely peak together.

In case of Indian equities, the asset class experienced strong phases between 2003 and 2007, 2013 and 2017, and once more in the post-pandemic period. Each phase was driven by a different set of factors. The 2003-2007 phase benefited from strong economic growth and rising corporate earnings, 2013-2017 phase was aided by low interest rates and global liquidity and the post pandemic phase occurred when monetary stimulus, healthy profitability and rising retail participation coincided.

When it comes to precious metals like gold and silver, they have followed entirely different trajectories. Their strongest periods often occurred when investors sought protection against uncertainty or inflation. Real estate as an asset class too has experienced its own cycles. The years between 2003 and 2013 represented a favourable phase. Conditions became difficult during the subsequent period, before improving again after 2020.

When looked at these asset classes together, it is evident that asset classes do not move in tandem. Their cycles differ in timing, duration and intensity.

Why Asset Allocation Matters

If different assets peak at different times, concentrating on any one asset class becomes risky. The objective of

investing, therefore, is not merely to identify winners but to allocate capital across various asset classes. Opportunities often emerge when certain asset classes become unpopular and consequently valuations become attractive. On the other hand, caution is warranted when excessive optimism drives valuations far above historical averages.

For example: Equities as an asset class was attractive in the early 2000s. As valuations became stretched by 2007, gold and real estate appeared to be relatively more attractive. Following the global financial crisis which ensued in 2008, the relative attractiveness shifted again towards equity. Similarly, during the sharp correction triggered by the pandemic in 2020, equities once again offered compelling opportunities.

Cycles Operate Within Sectors Too

The principle of cycles extends beyond asset classes. Industries themselves experience periods of expansion and contraction. Telecom, airlines, metals and power have all undergone repeated cycles. When it comes to sectors, it is often seen that high profitability attracts capital which encourages new entrants. This leads to excessive investment which eventually creates overcapacity and compresses returns. As a result, weak players exit, bankruptcies increase and capital finally exits the sector. Over time, supply and demand regain equilibrium, setting the stage for a gradual recovery.

This process repeats across industries and demonstrates that cycles are driven not merely by economics but also by human behaviour. Excessive optimism often sows the seeds of future disappointment.

When Correction Becomes Inevitable

Every major correction has one common feature which is excess. When valuations become detached from reality and optimism becomes widespread, markets become vulnerable. Excessive enthusiasm often creates the illusion that risks have receded or disappeared. History repeatedly shows that such periods eventually end in corrections. However, the exact timing of a correction is impossible to predict. Yet periods characterised by extraordinary gains and widespread complacency should always invite caution.

Why Comebacks Matter More Than Corrections

Although asset class corrections receive enormous attention, especially when it comes to equities, recoveries are equally important if not more. Every correction creates opportunities. Assets abandoned during periods of pessimism often become tomorrow's winners. Market history demonstrates that extreme optimism and extreme pessimism are both temporary states. Cycles ensure that neither lasts forever. Investors who remain anchored to fundamentals during difficult periods are often rewarded when sentiment normalises. Therefore, patience and discipline become critical virtues.

The Current Environment Calls for Moderation

One of the striking characteristics of the present environment is that very few asset classes appear to be at the bottom of their cycles. Equities, gold, silver and real estate have all delivered strong returns in recent years. Such conditions suggest that aggressive positioning in any of these asset classes may not be prudent. When opportunities are limited, balance becomes more valuable than conviction.

The Enduring Lesson

My three decades in markets has taught that cycles cannot be ignored even though they cannot be predicted with precision. Markets will continue to experience booms, corrections, and recoveries. Technologies will evolve, sectors will rise and decline, and investor emotions will oscillate between greed and fear.

Through all these changes, cycles will remain inevitable. Understanding them will not necessarily eliminate mistakes, but it can improve the odds of making better decisions over one's investing duration. This is important because better decisions compounded over time often matter more than accurate predictions.