

Mistaking cyclical earnings with structural growth

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As long-term investors, we regularly find ourselves in a conundrum.

Our regular quarterly Investment Strategy Group meeting took place earlier this week with the backdrop of elevated threat to stability from continuing wars in Ukraine and the Middle East, whilst our strategies are close to all time highs after a strong run in performance over the past year.

As valuation driven investors, we can understand (in hindsight) why our strategies have performed well in absolute and relative terms as other investors have flocked to the cheaper assets we already owned in Asia and emerging markets more generally, alongside the insatiable demand for investments in the Brave New World, SpaceX probably being the poster child of this cycle.

It is inevitable that the US market has in large part been driven up by the hype around AI driven ideas. The thing that makes us uncomfortable isn't actually the high valuation of the US technology market, it is the impact this has had on other areas which we have owned because they were cheap, namely selective Asian exposure. As global investors have sought to diversify from the US market, those Asian companies are now priced very differently to when we first invested three years ago, leading to a skewing of the market indices in that region. This potentially removes the diversification benefits these holdings provided a year ago.

We see certain US companies as likely masters of their own destiny for the foreseeable future. This makes them structurally better investments than the rest of the global equity market as they can grow with little regard for the economic cycle. This is a very rare thing and should not be misconstrued as a widespread phenomenon. History is littered with examples of such 'structural growth' companies becoming cyclical as their revenues falter.

Structural growth is driven by durable changes in technology, regulation, demographics, or behaviour, while cyclical tailwinds are temporary boosts from the economic or industry cycle. The practical challenge for investors is that both can look similar in the early stages: revenue accelerates, margins improve, and the stock rerates, but only one is built to last.

A good test is whether demand still grows in a slowdown. Structural growers usually keep taking market share from weaker competitors, expanding markets, or benefiting from long-term adoption, while cyclical beneficiaries tend to fade when pricing, volumes, or macro conditions normalize. Investors also need to ask whether the growth is coming from a one-off catch-up effect, such as restocking or commodity price spikes, versus a repeatable growth engine such as product innovation or network effects.

Three useful examples of the cyclical/structural conundrum currently are:

- Semiconductors: AI-related demand can create a structural story for leaders with real technology advantages, but memory pricing spikes are still cyclical and can reverse quickly.
- Industrials: Infrastructure spending may support years of strong orders, yet a lot of the upside can still be tied to the economic cycle rather than permanent growth.
- Consumer payments: Digital payments often reflect structural adoption because penetration can keep rising even in softer economies, making it more durable than a simple macro tailwind.

It is impossible to know until tested if these three examples are structural long-term changes or – maybe more likely based on historical evidence – cyclical. The key investor discipline is to separate “growth because the cycle is hot” from “growth because the business is fundamentally changing.” That means testing margins, order books, and market share across a full cycle, not just during the boom. Either way the team at Tacit is sceptical of any ‘structural growth’ narratives as history shows us that very few companies have shown themselves to be truly immune from an economic cycle.

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