

How to profit from Commodity & Cyclical Plays

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and is merely an effort towards enhancing learning and knowledge.



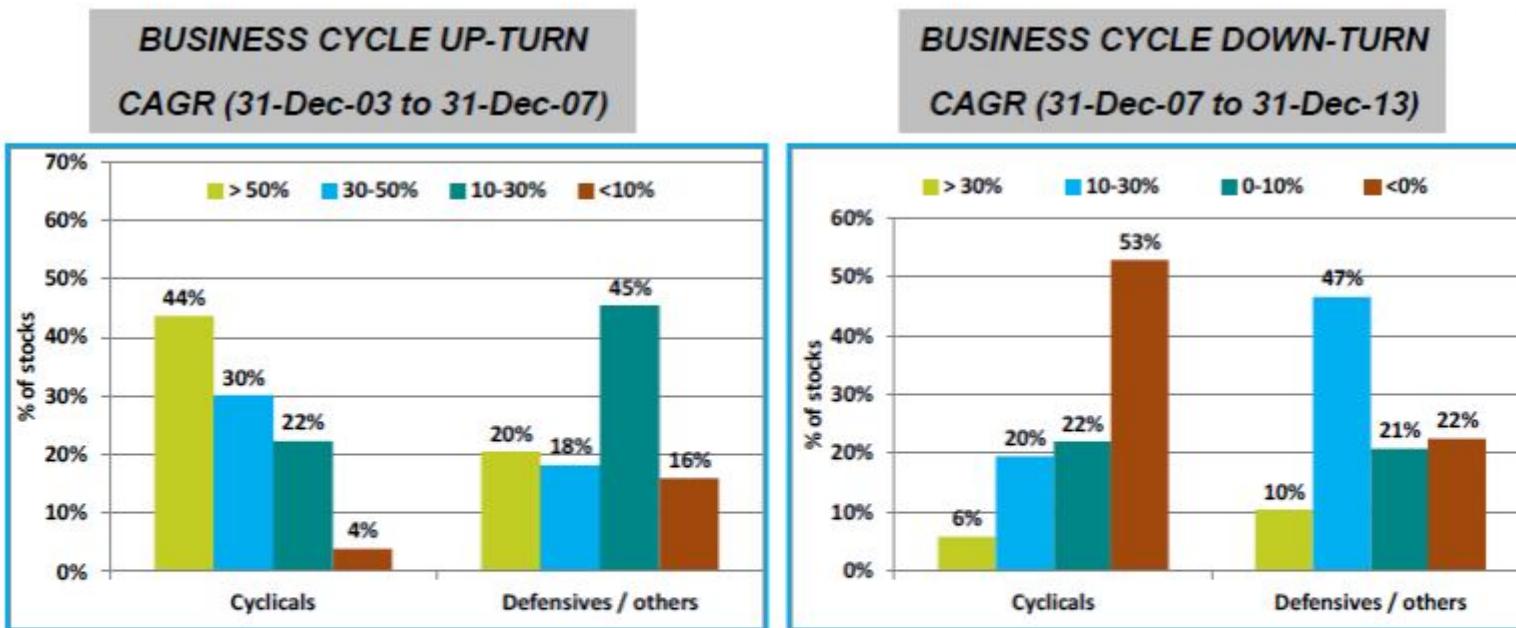
Factors

- Identify the commodity/cyclical
- Study the cycle of commodity/cyclical
- Look at macro-economic conditions
- If agri (esp sugar), study crop pattern nationally/internationally
- If metals/mining, study production data
- Check for capacity utilizations
- Check for capex (when many companies announce, great signal to relook/exit)
- Check the margins

Factors

- In agri, make decision based on crop failure/deficient monsoon
- Whether prices are domestically or internationally controlled
- Export/import possible in the commodity
- Check for anti-dumping duty
- Government intervention/control
- Check international prices
- Falling interest rates

Higher risk, higher returns



- Approx 3/4th of cyclical stocks delivered annualized return of more than 30% during business cycle up-turn as against only 38% of defensive and other stocks delivering CAGR in excess of 30%
- In contrast, during business cycle downturn, only 1/4th of cyclical stocks delivered annualized return of over 10% whereas 57% of defensive and other stocks managed to grow by CAGR of more than 10%

How ?

- Prepare a list of the stocks with the theme (about 10)
- Shortlist to 4/5 plays. Use basket approach in investing.
- Check if companies will survive another couple of years downturn (this stress test is very important)
- Wait for some companies to go belly-up. Buy after that.
- Start initial buying at highest pessimism levels.
- As cycle starts turning add.

How ?

- Check insider buying/selling
- Don't look at PE
- Price to book/replacement cost are better parameters
- Check if company has cash/manageable debt

Some Rules

- Always make positional plays
- These should never be 5-10 year plays
- Patience – Be ready to hold for a couple of years. One may add in that period
- Make sure portfolio allocation is adhered to.
- Never go more than 15-20% of your portfolio in a single commodity
- The longer the cycle, bigger the return (sugar stocks 9x)
- Never stay till the end. Start de-boarding the train before the last stop

Some Sample Baskets of last couple of years

- Sugar – Dhampur, Ugar, Triveni, Dwarikesh, Rajshree
- Paper – Kuantum Papers, Star Paper, West Cost Caper, Cosboard, BILT
- Cement – Deccan Cem, Saurashtra, Shree Digvijay, Andhra Cem
- Metals/Mining – Vedanta, Tata Steel, MOIL, NMDC, NALCO
- Polyfilms – Cosmo Films, Jindal Poly, Polyplex, Uflex
- Fertilizers/Agro – Bharat Rasayan, Chambal, Coromandel, Khaitan Chem

* Education purpose only. Some stories might have already played out.