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Investors Come Unhinged For Cyclicals – Finding Value In The Economic Reopening

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It's no secret that investors have decided in 2021 that reopening the economy means that cyclical stocks are the favorite investment vehicle. But are they?

Economists are expecting a boom this year. Further, with Biden planning to spend additional $Trillions of dollars on things like infrastructure, traditional cyclical companies have come back into favor.

Some of this rotation in favorite companies makes sense. Companies that make sense based on an infrastructure play include: Deere, Caterpillar CAT -1.4%, Cemex, United Rentals URI -0.3%, Freeport McMoRan FCX -2.4% , and Nucor steel NUE +0.2% .

But honestly, do you really want to invest in some of these other companies? How about the mall-based retail stores that are soaring, with stocks gaining this year-to-date on average +63%, including Macy's M -1.2%, Abercrombie & Fitch ANF -0.6%, Zumiez ZUMZ -0.3%, Nordstrom JWN -3.4%, Gap GPS -0.1%, and Chico's.

Airlines benefit as the economy reopens GETTY IMAGES

Or maybe, you just love those airlines? These stocks are gaining year-to-date on average 25%, including Southwest Airlines LUV +0.3%, Alaskan Air, Delta, American, Spirit Air, Allegiant Air, and United Airlines. These stocks have bad analyst ratings, and lots of "missed" earnings calls, not to mention the enormous losses in revenue. Naturally, people will want to travel when the economy reopens and airlines will benefit. But is this trend already played out? Have the stocks already taken flight too far, too fast?

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And don't forget about the commodity stocks. Let's all run to buy oil companies. Forget the fact that the pro-oil President is now gone and the go-green President is in office. Forget about the fact that oil prices have already

Oil refinery GETTY

rebounded to pre-pandemic levels. Forget about the fact that American drillers start making bucket-loads of money as oil prices have passed $60/barrel and that the Saudi's will turn back on the spigot to keep all those American wells from coming back on-line and flooding the market. Due to the Saudi oil production increases, the price of oil is not likely to top $80/bbl even during the summer this year. But don't overlook the fact that oil stocks are up an average this year-to-date of 43%.

Really? So these stocks are your flavor of 2021? Infrastructure makes some sense here. However, retail stocks make no sense here, neither do airline stocks. When have airline stocks ever done well in the face of rising oil prices? And oil stocks have already risen too much to warrant any further investment.

In the current dash-for-trash stocks, investors have forgotten about those companies that are making tons of profits and have the potential to continue to make increasing profits in the coming years (not focusing on weeks and months here, but on years). Instead, investors are focusing their investment dollars on short term predictions which will come-and-go all within this current year.

This year investors are ignoring the high-quality stocks beginning with big tech. This fact has been talked about and written about endlessly in 2021. It is almost literally raining money at some of these big tech firms. Google GOOG -1.4%, Microsoft MSFT -0.4%, Apple AAPL -0.7%, Amazo AMZN +1% n, Qualcom, Salesforce CRM -1.3% among others. And when a company has a very large amount of cash on the balance sheet, and has announced a stock buy-back program, that cash (and maybe even some debt) will be used in the near future to reduce the E in the P/E ratio. So, a PE ratio of 30 may not be a PE ratio of 30 after the buy-back. It may become a PE ratio of 20 as the company purchases shares with cash and debt.

Take note also that as these big tech firms move through time, they are generating massive quantities of cash and buying down their stock float; meanwhile the stock prices are not going up. All this adds up to a future PE ratio quite a bit lower than what might typically be calculated on financial websites.

Corporation	PE ratio as it appears on financial websites	Cash on Bal Sheet	Buy-Back program?
Google	25	$157B	$15B ready
Microsoft	30	$136B	$30B ready
Apple	24	$195B	$82B ready
Amazon	45	$84B	$5B ready
Salesforce	48	$12B	$2B ready
Qualcomm	16	$11.5B	$6B ready
Facebook	21	$68B	$33B ready

Big Tech Firms PE Ratios WARREN FINANCIAL

Which leads to the final point on profitable companies that are currently being ignored. Those big cap tech firms have the largest impact on the calculation of the SP500 itself. If the PE ratios aren't as high as they appear because of cash and cash-flow generation and buy-backs, then the combined SP500 PE ratio may be lower than it appears.

Next on the list of great companies being ignored, and a sector that should benefit from the reopening, are medical device companies. Procedures in hospitals are no longer being delayed due to Covid which is benefitting Intuitive Surgical ISRG -1.9%, Stryker SYK -1.4%, Baxter, Zimmer, Dexcom DXCM -2%, Illumina ILMN -0.8%, Boston Scientific BSX -1.2%, and Edwards. Only ISRG in that crowd is performing well this year – all those other stocks are underperforming the S&P500 this year. Meanwhile, some of these companies have amazing growth and stronger than ever prospects for future growth.

The lemming crowd has also left traditional credit card companies and even fin-tech companies in the dust this year – despite the fact that some of these companies also have great growth and will benefit from increased travel and spending outside the home as the economy booms. Companies that have underperformed the SP500 thus far in 2021 include Mastercard MA -0.9%, Visa V -0.2%, Global Payment, and Fleetcor. Even PayPal PYPL +2% has underperformed the SP500 this year despite a revenue growth rate of +21% year-over-year and earnings growth for the trailing-twelve-months of +71%.

New home under construction GETTY

Considering that a blind squirrel may in fact find a nut once in a while, the group that the lemmings are getting correct is home builders. This group is still “investment worthy” and is doing well this year with average gains well into the 40%+ area. It makes reopening sense to continue to focus on Home Depot HD -3.1%, Lowes , Floor and Décor , Toll Brothers TOL -1.3% , Restoration Hardward RH -1.7%, Lennar LEN -1.6%, D.R. Horton, and Pulte Group.

If you talk to one of these lemmings, you will definitely get them to light-up over speculative plays like Bitcoin, and the crazy trash stocks listed above. Just don’t talk to them about fundamentals like revenue and earnings growth. Their eyes will glaze over, and they will change the subject to Dogecoin.

Dogecoin ASSOCIATED PRESS

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