Cyclicals and Compounders

Last week, we highlighted the JSE's strong performance, driven largely by the resource sector. While the exact year-to-date figures have been impressive amid a global commodity upswing, much of this gain has come from classically cyclical businesses, particularly miners.

For JSE investors, these returns are welcome, but they underscore an important point: the source of the gains matters. The JSE is dominated by resource-heavy companies, and their performance is inherently linked to volatile commodity and economic cycles.

What is a cyclical business?

A cyclical business experiences earnings that fluctuate significantly with economic conditions or commodity prices. Booms produce outsized profits (and share price surges), while downturns often result in sharp contractions, losses, or prolonged periods of stagnation.

This leads to high volatility, meaning investors cannot simply "buy and hold" without careful timing or a strong view on the cycle.

Gold miners are a prime example:

1) Gold prices have risen approximately 55% in 2025.
2) This has translated into massive share price gains for companies like Gold Fields (up 180% year-to-date) and AngloGold Ashanti (up over 220% year-to-date).

Yet, while gold itself has compounded at roughly 11% annually over the past 25 years, gold miners' returns have been far lumpier.

Consider Gold Fields:

1) The share price spiked to around R125 in the early 2000s boom.
2) It then traded sideways (or down in real terms) for nearly two decades, ending 2022 at similar levels to 20 years prior, delivering essentially zero real gains for long-term holders before the recent surge (with prices now in the R600–R800 range depending on timing).

The JSE is unusually cyclical due to its heavy weighting in mining and resource stocks, including Anglo American, Glencore, BHP, Sibanye Stillwater, AngloGold Ashanti, Kumba Iron Ore, Exxaro, and Sasol (which is tied to oil and chemical cycles).

Compounders: The Steadier Alternative

Compounders, by contrast, are high-quality businesses that grow earnings with greater predictability, often regardless of short-term cycles. They typically exhibit:

1) Lower earnings and share price volatility.
2) Strong economic moats that support consistently high returns on equity.
3) Stability that supports a genuine long-term "buy-and-hold" strategy.

In South Africa, true compounders are relatively scarce, but some possible examples could include Naspers with its exposure to Tencent, Discovery, Capitec, British American Tobacco, etc.

Even some retailers like Clicks or Shoprite can behave like partial compounders in good years, though consumer discretionary spending adds an element of cyclicity.

Constructing portfolios

Cyclicals pose unique challenges: huge drawdowns in bad years, and the need for more precise timing. As a result, many professional fund managers avoid taking strong cyclical views altogether, preferring a core allocation to compounders for reliable long-term wealth creation.

However, in a banner year for resources like 2025, the value of including a manager skilled at navigating commodity cycles becomes crystal clear.

Ian De Lange CA(SA)
Chief Investment Officer

If you have any questions, Ian and our team would love to hear from you on global@seedinvestments.co.za.

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