

# When inflation comes don't look at sectors, look at business models.

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The start of 2022 marked one of the most violent equity rotation on record, with many of the “growth” stocks that used to be the darlings of 2020 and 2021 falling sharply, particularly the valuation-rich technology companies that profited well from the “covid-economy”. On the contrary, “value” stocks and sectors like energy, banks and generally cyclical names saw a dramatic rebound from depressed valuations.

A lot of this move is explained by the acute increase in realized inflation, inflation expectations and consequently interest rates and monetary policies. Indeed, in a high inflation environment the majority of asset managers and research houses focus and recommend to invest in value versus growth, cyclicals compared to defensives, some sectors compared to others; although this might be a quick and partially successful way to surf the first wave of a market rotation, it is in our opinion a naive approach to invest for the long term in a scenario of persistent inflation.

Ultimately the only way to assess if a stock, and hence a company, is able to thrive in an inflationary environment is to look at its business model, regardless of the sector in which it operates. Let's consider two apparel & accessory producers, one selling bags for 50 euros and the other for 3000. Although they are classified in the same equity sector, the first one will probably have very little brand recognition, higher competition, lower margins, non-captive distribution channel and ultimately a so called “high price elasticity”. On the contrary the second company will enjoy a faithful customer base, large margins, captive distribution channel and a relatively



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inelastic price. If for those companies transport, wages and raw material prices increase, it is clear that the impact on profits or their ability to pass inflation to the end consumers is very well apart.

This is obviously a straightforward example, however parallelisms like this can be found in every industry, and also both in “value” and “growth” stocks. It is hard to forecast for how long inflation will be with us, but when it comes to sound long term investing it is important to look below the surface as sectors and styles can be deceiving: in the long term a stock will track the economic performance of a business, and each business is different.