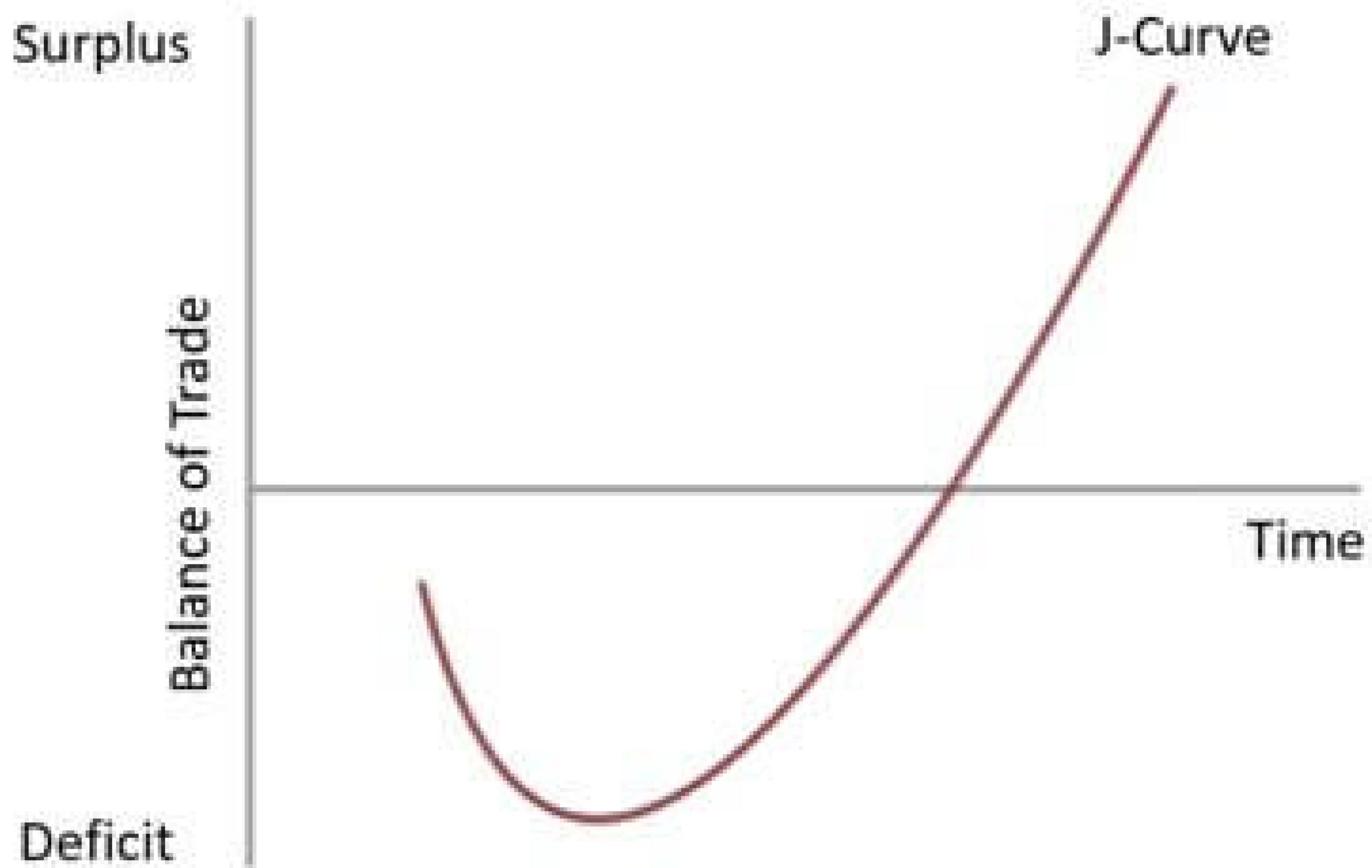
WHAT IS J-CURVE?



SWIPE

A J-curve is a trendline that shows an initial loss immediately followed by a dramatic gain. In a chart, this pattern of activity would follow the shape of a capital "J".

The J-curve effect is often cited in economics to describe, for instance, the way that a country’s balance of trade initially worsens following a devaluation of its currency, then quickly recovers and finally surpasses its previous performance.

J-curves are observed in other fields including medicine and political science. In each case, it depicts an initial loss followed by a significant gain to a level that exceeds the starting point.

The J-curve is useful to demonstrate the effects of an event or action over a set period. Put bluntly, it shows that things are going to get worse before they get better.

In economics, it is often used to observe the effects of a weaker currency on trade balances. The pattern is as follows:

- Immediately after a nation's currency is devalued, imports get more expensive and exports get cheaper, creating a worsening trade deficit (or at least a smaller trade surplus).

- Shortly thereafter, the sales volume of the nation's exports begins to rise steadily, thanks to their relatively cheap prices.

- At the same time, consumers at home begin to buy more locally-produced goods because they are relatively affordable compared to imports.

- Over time, the trade balance between the nation and its partners bounces back and even exceeds pre-devaluation times.

SWIPE

The devaluation of the nation's currency had an immediate negative effect because of an inevitable lag in satisfying greater demand for the country's products.

When a country’s currency appreciates, economists note, a reverse J-curve may occur. The country’s exports abruptly become more expensive for importing countries. If other countries can fill the demand for a lower price, the stronger currency will reduce its export competitiveness.

Local consumers may switch to imports, too, because they have become more competitive with locally-produced goods.

The J-Curve in Private Equity

The term J-curve is used to describe the typical trajectory of investments made by a private equity firm.

Private equity firms have a different path to profitability than public companies or the funds that invest in them.

Their portfolios, by design, are made up of companies that were performing poorly when they were purchased. The firm then spends substantial amounts of money retooling the company before spinning it off as a renewed company.

That means an initial decline in performance followed, at least theoretically, by a steep improvement in performance.

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