3 Stocks to Avoid in a Market Correction

Description

As of yesterday's close, even with the sell-off this week, the **S&P/TSX Composite Index** (^GSPTSE) is still at levels not seen since the pre-1998 meltdown. If you are like me, feeling uneasy about valuations and that stocks may be vulnerable to weakness, does that mean you should get out of equities altogether? No, but what we should be doing is getting rid of those stocks that are particularly vulnerable in a weak market, and concentrate our holdings on those stocks that are likely to outperform.

Here are three companies that should be avoided if investors believe that there is a correction looming.

1. Valeant Pharmaceuticals

With **Valeant Pharmaceuticals** (TSX: VRX)(NYSE: VRX), the issue is two-fold: valuation and strategy. The stock has a one-year return of 37%, although it has come down as of late. Nevertheless, Valeant Pharmaceuticals has been a very strong performer. However, investors should be cautious with this name, especially in a market correction, as valuation levels are high.

The company has had net losses in the last two years, and the stock is trading at a price-to-cash flow ratio of almost 34 times. Furthermore, its strategy is to grow through acquisitions, and the sustainability of this strategy is questionable. In addition, these acquisitions have largely been financed with debt, so the company currently has a heavy debt load on its balance sheet.

2. Ballard Power Systems

I love **Ballard Power Systems** (TSX: BLD)(NASDAQ: BLPD) and have written about it numerous times. Ballard has lowered its risk profile by diversifying its revenue base. Its sources of revenue now span from telecom backup power to power generation, buses, and engineering services.

In the first quarter of 2014, the company's revenue was segmented into four divisions: telecom backup power, at 20.7% of revenue; material handling, at 14.3% of revenue; engineering services, at 52.9% of revenue; and development stage markets, at 12.1% of revenue. It is on the verge of becoming profitable and its balance sheet is strong. However, in a weak, nervous market, a company with no earnings and trades at almost nine times sales will not fare well.

3. Sierra Wireless

Sierra Wireless (TSX: SW)(NASDAQ: SWIR) is another company that I am very positive on, but my issue here also comes down to valuation. It is turning the corner into profitability, but it currently trades at a whopping 41 times cash flow. Once again, if you believe that the market is in for a correction, it will not take kindly to this type of stock. However, I would also keep this one on the back-burner, ready to get in when valuations become more reasonable, for multiple reasons.

The company has exposure to a wide range of industries that will fuel growth, so it is diversified and has numerous growth drivers. The automotive sector, for example, will be a big growth driver for Sierra, as its penetration rate is currently quite low, at roughly 10%, and according to forecasts, the market is set to grow at a CAGR of over 30% for the next five years and to reach over $130 billion. The health care industry also represents a potentially lucrative long-term opportunity for Sierra Wireless. In the energy segment, smart metering has been on the rise here in North America for quite some time.

The latest results, for the first quarter of 2014, saw 19.5% revenue growth including acquisitions. Organic growth was also strong at 17%, and ahead of expectations. The company expects second quarter revenue to increase 18% and gross margins of 31%+ accompany this growth rate.

Sierra Wireless also has a healthy balance sheet, with $150 million in cash and no debt.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:BLDP (Ballard Power Systems Inc.)
2. NASDAQ:SWIR (Sierra Wireless)
3. NYSE:BHC (Bausch Health Companies Inc.)
4. TSX:BHC (Bausch Health Companies Inc.)
5. TSX:SW (Sierra Wireless)

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