When to Catch a Falling Knife: Shopify Inc.

Description

As the old saying goes, “Never catch a falling knife.”

For most, this is a lesson learned early on after what seems to a very attractive security is bought and money is lost in spite of what was a very attractive price. Although there is sometimes what is known as a V-shaped recovery, many investors can attest through personal experience that this very rarely happens.

In the past week, famed short seller Andrew Left from Citron Research has publicly called **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) a “get-rich-quick scheme,” which led shares to decline by more than 10% on the news. While many investors will be viewing this as an excellent buying opportunity, the truth remains that the fundamentals of this growth company are now under the microscope. Although there is very little, if anything, that was learned by investors (from Andrew Left), the business model of the company has still come under fire due to the methods used to bring new customers to the platform.

As the growth of the company has been astonishingly good over the past few years, investors who’d previously believed they missed the boat may need to take a big step back before jumping in to this name. The share price has pulled back amid a bright light being shined on the company’s business practices. Let’s look at a previous target of Andrew Left. Shares of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), which previously traded at a price in excess of $300, are now under $20 per share as the company was forced to make significant changes to the way it was run.

There are certain times when the overall market seems to really appreciate what a certain company or sector has to offer, whereas during other times, it would seem that the company can’t catch a break. For investors who were around during the internet’s boom times of 1999 and 2000, the story was the same: invest here for potential. Currently, shares of Shopify are like the tech bubble, version 2.0. Over the last 17 years, many older investors and bankers who’d witnessed the events of the tech bubble have since retired, and young investors and bankers may need a history lesson.

Looking at technical indicators, such as the simple moving averages (SMA), shares of Shopify are still trading at considerably more than the 200-day SMA at current levels. Clearly, shares were running too far, too fast to sustain the expectations from investors. Just as in the case of Valeant, investors will need to wait for at least the 50-day SMA to catch up to the share price from above (meaning after a sell-off) to consider that a stock has bottomed. Depending on the investment time frame, certain investors may also want to be patient for the 100-day or 200-day SMAs to converge as well.

CATEGORY

1. Investing

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2. NYSE:SHOP (Shopify Inc.)
3. TSX:BHC (Bausch Health Companies Inc.)
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