



Is Buying Oversold Stocks an Effective Strategy?

Description

There are many different investing strategies that investors can apply, and I'm going to look specifically at buying oversold stocks, or buying on the dip. The big danger with this is, of course, that a poorly performing stock will only continue to plunge in value. However, if you buy near the bottom, the stock could net you a significant return.

Over the past several months, I've identified many stocks that were oversold, and now I'm going to look back to see how some of those shares have performed since.

Back in September, **Sierra Wireless, Inc.** ([TSX:SW](#))([NASDAQ:SWIR](#)) [was oversold](#) with a Relative Strength Index (RSI) of just 28. At that time, the stock was trading at just over \$26 and would go on to rise to a high of over \$30 before dropping to a low of \$24.

Currently, the stock is still over \$26, as it has been stuck in a range for the past several months. The problem is that Sierra's stock has been oversold multiple times over the past year, and a low RSI level may not mean as much to investors anymore.

Keyera Corp. ([TSX:KEY](#)) was even more oversold at the time, as the stock was at an RSI level of just 26. The share price would go on to rise from under \$36 up to a high of over \$39, but it too would eventually follow a similar path to Sierra's.

Canadian National Railway Company ([TSX:CNR](#))([NYSE:CNI](#)) was oversold back in August when its [RSI was just 22](#). Since then, the share price has also been volatile, but it would have yielded you a return of over 5% if you'd held on to the stock until today.

Valeant Pharmaceuticals Intl Inc. ([TSX:VRX](#))([NYSE:VRX](#)) was at an RSI of under 30 in September when it was trading at just over \$16. The share price has gone up more than 80% since then, although not before briefly dipping.

However, Valeant got a boost in its share price when it announced it would be restructuring its debt; otherwise, the returns would not be as significant, and so it would be hard to credit the stock being oversold as the catalyst behind the rise in value.

Does buying oversold stocks work?

This is a small sample size, and each of the stocks listed above did go up in price after reaching an oversold status. So, in that sense, the RSI did work in communicating that a reversal could be likely, but investors should be careful not to expect too much from the technical indicator.

What are the takeaways for investors?

There are some important conclusions we can come to despite this small sample.

The first is that RSI has value in indicating when a stock might be due for a recovery, but don't expect that it will tell you when it will happen or how long it will last.

Second, if a stock has reached a low RSI number (less than 30) multiple times in the past year, then it crossing over into oversold territory is less significant than for a stock that previously had not been oversold.

Finally, investors should use technical indicators like RSI in conjunction with fundamental analysis. Investing based on technical indicators can be dangerous, and by investing in stocks that have strong fundamentals, investors will be less exposed to those risks.

CATEGORY

1. Investing

TICKERS GLOBAL

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2. NYSE:BHC (Bausch Health Companies Inc.)
3. NYSE:CNI (Canadian National Railway Company)
4. TSX:BHC (Bausch Health Companies Inc.)
5. TSX:CNR (Canadian National Railway Company)
6. TSX:KEY (Keyera Corp.)
7. TSX:SW (Sierra Wireless)

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