



## Look Out Below! These 2 Stocks Could Be Heading for a Massive Plunge

### Description

Value traps are out there, but they can be hard to spot. They're Kryptonite to value investors who get lured in by the siren song of their depressed valuations. Although it may appear that a margin of safety is present with such stocks, many investors could back themselves into a corner if their "cheap" stocks continue to get cheaper as the problems mount.

If you'd welcome the opportunity of a further decline in the share price of the stock in question, then you're putting yourself at risk of digging yourself into an even deeper hole as shares plummet. It's very important that you've formed a solid thesis before you've even considered nibbling away at shares; that way you don't have to put yourself in a situation where you need to reconsider why you bought your shares in the first place.

A lot of the time, many investors buy such cigar butt stocks because of the fact that they're cheap based on traditional valuation metrics. This simply isn't enough justification to purchase shares of a company; in fact, it's dangerous.

Consider the following stocks that are pretty "cheap." I think the margin of safety that the cheapness may imply is nothing more than a mirage that could hurt value investors once things get uglier.

#### **IGM Financial Inc. ([TSX:IGM](#))**

IGM is a value trap that has plunged ~10% since I called it my "short of the year for 2018" just a few weeks ago. Yes, the broader market pulled back since the piece was published; however, unlike many stocks that have since recovered some of the losses from the recent dip, IGM hasn't, and I think it's heading much lower because of the secular decline of the industry it's in.

IGM's business is tied to the sale of high-fee mutual funds to its clients, and given the industry is moving towards lower-fee investment management options, IGM is likely to experience a huge hit to its bottom line over the next few years, as it's forced to lower its obscene MERs, which are well north of 2%.

Sure, robo-advisors give IGM a new growth outlet; however, I do not believe the associated fees will be

anywhere near the 2-3% for its human-managed mutual funds. IGM is set to benefit from cost-containment initiatives, but I don't believe they're nearly enough to offset the massive headwinds that the company will be facing, as the investment management tech improves alongside with the financial literacy of the average Canadian.

### **Magna International Inc. ([TSX:MG](#))([NYSE:MGA](#))**

Magna trades at a 9.66 price-to-earnings multiple, a 1.8 price-to-book multiple, and a 5.6 price-to-cash flow multiple. All are lower than the company's five-year historical average multiples of 10.8, 1.9, and 6.9, respectively.

The stock, although seemingly trading at a discount to historical norms, should be much cheaper given the long-term issues that Magna will have on its plate.

Magna is in a ridiculously competitive and capital-intensive industry, and given Trump's protectionist tone, it's likely that foreign auto part makers like Magna could come out as some of the biggest losers once all is said and done. Magna stands to experience volume declines, which would be catastrophic for Magna's bottom line, resulting in a correction to the company's P/E.

In addition, Magna is dangerously cyclical, so come the next recession, the stock will get obliterated, and it won't matter how cheap the stock may seem today. Shares of Magna lost ~74% of their value in the last recession.

### **Bottom line**

It's a common fallacy that cheap stocks are less risky and have less downside.

Often, extremely low multiple stocks are indicative of a troubled company for which there's no simple solution to get out of the gutter. In an age of technological innovation, there are also cases of companies that stand to get punished over the long-term due to industries that are in secular decline.

When dealing with such beaten-up names, you need to exercise extreme caution, since you're taking on just as much, if not more, risk than you would with an extremely overvalued stock.

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### **CATEGORY**

1. Investing
2. Stocks for Beginners

### **TICKERS GLOBAL**

1. NYSE:MGA (Magna International Inc.)
2. TSX:IGM (IGM Financial Inc.)
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