Is After a Scandal Hits the Time to Buy a Stock?

Description

When bad news hits a company, it can have a devastating effect on its share price. Scandals can last for a long time and can keep a stock down for a long time, but after that, the share price could very well recover, which begs the question:

Should you buy a stock after it has been rocked by a scandal?

As crazy as it may sound, when bad news hits, it might be an ideal time to think about hitting the buy button. The important thing to note, however, is to understand the context of the news and what it means for the company. If the company's business model is impacted and its ability to turn a profit has been compromised, then you should stay far away from the stock. If, however, it's simply a case of bad publicity that will fade over time, it might be worth buying the stock should it see a dip in price.

Last year, United Airlines, which is owned by **United Continental Holdings Inc.** (NYSE:UAL), had a public-relations nightmare when video surfaced that showed a man being forced off one of its flights, leaving him bloodied from the incident. Back then, you may have expected that it would have had a detrimental impact on the airline's share price, but you'd be wrong. United's stock did have a small dip in price, but it was up in the weeks afterward, and since the incident, the share price has risen by more than 25%.

Equifax Inc. (NYSE:EFX) had a much more serious scandal when a year ago it reported that it had been breached and that sensitive data had been compromised. Data breaches are nothing new, but Equifax's whole business model surrounds protecting information and keeping it safeguarded. This is the type of thing you would expect might cripple a business. And while the stock did come crashing down after the news, it has only declined 6% since then, and if you had bought a few weeks after when the sell-off was finished, you would have netted a return of over 26% today.

Closer to home, **Home Capital Group Inc.** (TSX:HCG) is a good example of a company that ran afoul with investors. The company's scandal involved misleading investors and sent the stock crashing down to less than half of its value. While the share price is nowhere near where it was before the scandal hit, if you had invested a month after the big crash in price, you could have got in at around $9, which would have produced a return of over 60% today.

However, because the company's problems were also tied to liquidity, Home Capital presented a lot of risk and wouldn't have been a stock that would have fit the criteria of just being hit by bad press. And if not for the injection of cash it received from Warren Buffett, Home Capital could have ended up in a much more dire situation.

Bottom line

Bad news does present an opportunity for investors to buy a stock at potentially a deep discount, but careful analysis should be done before making that decision. The returns could be significant, but the risk likely is as well.

CATEGORY

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2. TSX:HCG (Home Capital Group)

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