Warning: I’d Sell These “Hyper-Cyclical” Stocks Pronto

Description

Most pundits would agree that we’re in the late stages of the market cycle. A recession, like Lord Voldemort from *Harry Potter*, is a word that investors dare not say out loud, but like it or not, the state of the global economy is going to continue to look gloomier by the day as China’s Trade-war-induced economic slowdown spreads across the globe.

While the Trump Slump could certainly transform into a Trump Rally on the announcement of a deal, investors would be wise to avoid being overweight in any hyper-cyclical stocks as we dive headfirst into a year that could be full of surprises.

So, without further ado, here are three overly cyclical stocks that appear to have an unfavourable risk/reward trade-off:

Magna International (TSX:MG)(NYSE:MGA)

I don’t care how cheap the auto part makers are at this juncture; they’re not the kind of companies you’ll want to be hanging on to when the economy heads into a tailspin.

With shares trading at 8.9 times forward earnings and just 7.5 next year’s expected earnings, the stock looks like a deep-value play with a wide margin of safety, especially relative to the company’s historical average P/E of around 10.

The 2.53% dividend yield may seem like the cherry on top of a cheap sundae, but unfortunately, many new investors may be unaware that the company may suffer from substantial multiple expansion as earnings flop in the event of a severe downturn.

You see, just because the stock is cheap doesn't mean it can't get cheaper. And if you think a recession at some point over the next three years isn't out of the question, you should be reducingyour exposure to hyper-cyclical auto part makers like Magna. Nobody buys expensive, long-term discretionary items like cars in a downturn, and as we've witnessed in the last recession, investors stand to face amplified downside relative to most other stocks in the TSX index.

Manulife Financial (TSX:MFC)(NYSE:MFC)

Manulife is another interesting company whose stock seems pretty cheap, but given the low-ROE John Hancock business and the higher-growth Asian exposure, which may take a hit in a China-driven global slowdown, I'd wait on the sidelines for an even better price, which could be in the cards at some point over the next year.

The 4.8% dividend yield is the highest it's been in recent memory, and while that's seen as a green light for the income-oriented investor, Manulife, like Magna, could suffer from multiple expansion if we were to fall into a recession. Insurance products are a tough sell when times are tough, especially life insurance products, which are seen as “optional” and not essential through the eyes of millennials, who have delayed starting a family primarily due to economic reasons.

Moreover, given how poorly Manulife was positioned in the last recession, I'm skeptical over the company's abilities to weather the next storm. There have been significant fundamental improvements that have happened since 2008, but I do not believe the stock will be immune from another amplified plunge come the next big decline.

Foolish takeaway

Hyper-cyclical stocks are cheap for a reason. We're in the late stages of a market cycle, and there's already been plenty of economic indicators that suggest we could be in for a doozy.

While hyper-cyclical stocks could soar in the event of a China-U.S. trade deal, betting on such stocks would be akin to betting on the outcome of a coin toss, and for most prudent investors, that's not a bet worthy of making.

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