Your Overvalued Stocks Are a Liability: Is It Time to Sell?

Description

There comes a point just before a widespread market downturn where an overvalued stock reaches its peak and suddenly begins to fall. Recognizing the moment when the wave of a recession is about to break is extremely difficult, and many a trigger-happy sell-off has occurred when the alarm turned out to be false.

However, with numerous threats facing a global market already rife with uncertainty, it might be prudent to at least go through a stock portfolio and identify which investments to keep and which ones are dangerous liabilities. Let's start with the latter, and then move on to the type of stocks to stay invested in ahead of a potential recession.

Overvalued tech and industrial stocks are too risky to hold

Investors may want to go through their portfolios and weed out any tech stocks with high P/E and P/B ratios. Stocks such as **Descartes Systems Group** (TSX:DSG)(NASDAQ:DSGX) spring to mind here, with its P/E of 101.1 times earnings and P/B of 5.9 times book, making it a sitting duck.

Raking over the rest of its value data, we can see that it's overvalued by around $15 a pop according to future cash flows, with a chunky PEG of 3.8 times growth.

There are certainly reasons why this stock is popular: a healthy ticker with just 4.8% debt, Descartes Systems Group returned 41.7% in the last 12 months, leaving the Canadian software industry in the dust, while a 27% forecast growth of earnings is somewhat enticing.

A popular stock and one of the best consumer durables in terms of quality and market share, **Canada Goose** TSX:GOOS)(NYSE:GOOS) is nevertheless overvalued, and a full-blown recession could hit its bottom line. Indeed, a populace feeling the pinch may find reasons to shop for cheaper apparel elsewhere, in turn potentially sparking a sell-off of the luxury wear stock.

Investors bullish on Canada Goose often point to its growth and overlook its valuation, arguing that the former outweighs the latter. However, it's a stylistic choice, and the cautious investor may want to do the opposite and look past 12-month returns of 29.2% towards market ratios such as a P/E of 50.4 times earnings and a P/B of 18.6 times book, which are clear signifiers of high overvaluation.

It may be time to get deeper into utilities

For a mix of energy types and some ready geographical diversification, as well as solid all-round stats and a healthy outlook in term of earnings growth, an investor arguably would be hard-pressed to find a better stock than **Algonquin Power & Utilities** (TSX:AQN)(NYSE:AQN).

Returning 22.6% over the past year and solidly outperforming its sector, this low-volatility energy stock belongs in a cautious investor's portfolio looking for a combination of stability and profitability. A 17.5% estimated growth in earnings and impressive past-year growth make it a good stock to replace overvalued growth stocks, such as the previous two tickers.

The bottom line

The risk-taking investor playing the market for capital gains would no doubt favour Canada Goose's 29.8% estimated growth in earnings; however, the cautious long-term stockholder buying for dividends should stick to utilities like Algonquin Power & Utilities, with its stable share price and handsome dividend yield of 4.84%.

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