A Beginner's Guide to Growth Investing

Description

Growth investing has been the road to riches for more than a decade. With high-powered darlings like **Facebook, Inc.**, **Shopify Inc**, and **Netflix, Inc.**, the tech sector has led the way, delivering multi-bagger returns again and again.

These days, investors are also throwing money at high-growth cannabis stocks like **Green Organic Dutchman Holdings Ltd** and **Cronos Group Inc**.

Tech and cannabis aren't the only games in town, however. There are plenty of growth stocks across every industry, including retail, energy, transportation, and more.

Opportunities abound, but don't forget about the associated risks. When growth stocks falter, they can drop by 30% to 60% in a matter of weeks.

The upside is often worth the risk, but there are plenty of ways to boost your odds of success. Here are three beginner tips to make sure your growth investing days are as rewarding as possible.

Don't pay too much

The number one thing that dictates how much you *earn* is how much you *pay*. It doesn't matter how quickly a company is growing—it's possible (sometimes easy) to overpay.

If a company grows revenues by 50% this year, but you paid a price that implied 60% growth, you could actually *lose* money on your investment. Always remember: the value of every investment is a function of how much you pay for it.

Canada Goose Holdings Inc. (TSX:GOOS)(NYSE:GOOS) is a perfect example. After IPO'ing in 2017, shares tripled within 24 months. Revenue and profit growth continually outpaced expectations, pushing its valuation close to 100 times earnings.

After peaking at around $90 per share in October of 2018, the stock sank by more than 50% as growth started to slow.

To be sure, management still expects sales and profits to grow between 20% and 30% annually, but the market had expected the rate to be a bit higher. The valuation came down tremendously to reflect the reset in expectations.

At one point, Canada Goose was trading at less than 30 times forward earnings. The stock has increased by nearly 50% since I pointed out how cheap shares were.

The lesson here is that just because a company is growing, doesn't mean you'll make money on the stock. Make sure that the price you're paying for this growth reflects reality.

Find structural growth

A great way to ensure that a company's growth engine won't disappear is to invest in industries with structural growth in demand. Most investors don't consider **Enbridge Inc.** (TSX:ENB)(NYSE:ENB) a growth stock.

In fact, its 6.6% dividend often gets it classified as an income stock. But don't be fooled—this is a growth story.

Since 2000, investors have experienced a total return of nearly 1,000%. That breaks down to annual returns of more than 25%! It's easy to turn thousands into millions at that growth rate.

Most important, Enbridge's customers need the company to survive. Very often, oil producers have no other choice than to use local pipeline infrastructure, which Enbridge owns and operates.

Oil output in Canada is expected to rise every year until at least 2030, which means Enbridge doesn't need to create demand through sales or marketing—its customer base will buy pipeline capacity no matter what.

Watch the pivot

One of the biggest mistakes many growth investors make is to continue holding a stock even as the story changes. When a high-growth company transitions into a lower-growth story, the valuation can take a huge hit, leading to 30% losses in a single day. This happens to growth companies all of the time.

Consider **Cargojet Inc.** (TSX:CJT). Over the last five years, revenue has grown by 22% annually. Net income has grown even faster. Cargojet deserves recognition, but it now has leading market shares across every vertical.

It dominates its domestic market and it's not clear where future growth will come from. The stock is priced in a way to reward past success, but future growth will be much harder to find.

Cargojet is priced at a lofty 94 times forward earnings despite a potential growth cliff. When the growth story is set to change, it's best to rethink your price and valuation immediately.

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2. NYSE:GOOS (Canada Goose)
3. TSX:CJT (Cargojet Inc.)
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Date
2025/08/24
Date Created
2019/08/11
Author
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