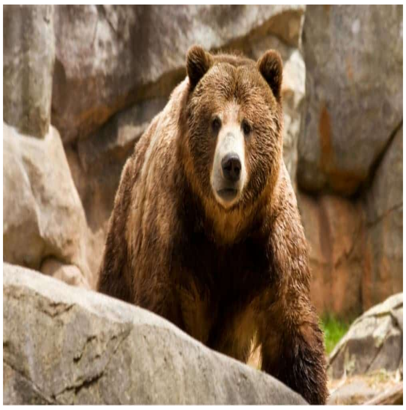

The Easiest Way to Identify Good Investments in Bear Markets

Description

Cannabis earnings are still shaking up the Toronto Stock Exchange (TSX) and wise investors can learn much from last quarter's earnings. The quarterly updates arrive as the U.S. trade war sparks a significant selloff on the TSX. Unfortunately, investors are reacting bearishly to the newly legal industry.

So, are the sell-offs a temporary market move or a buying opportunity? Good stocks can quickly become underpriced in a bear market, so it is essential to know how to differentiate between a buying opportunity and a bad stock with low return potential.

The easiest way to identify a good investment in a bear market is to look at the dividend yield, levered free cash flows, and changes in debt levels. Investors who feel overwhelmed when looking at all the numbers on a balance sheet should dilute the information down to three of the most critical indicators of return and profit. Let's look at **Charlotte's Web Holdings** (TSX:CWEB) as an example.

Charlotte's Web Holdings announced earnings for the quarter ended June 2019 on Wednesday. Although Charlotte's Web is the market share leader in CBD hemp extracts, investors reacted bearishly to the stock's earnings update. The selloff reaction could easily have been incited by U.S. President Donald Trump's trade war and the accompanying fear-based selloffs.

No dividend returns

Charlotte's Web does not issue dividends to shareholders. If a non-dividend issuing stock is experiencing volatility, the chances are that the stock is terrible news for serious, long-term investors. Bearish declines in these instances are more than likely not due to temporary price fluctuations.

Selling stocks for capital gains is the only way for a shareholder to realize returns from non-dividend issuing equity. This means the stock is likely a victim of speculation from short-term investors. Long-term tax-free savings account (TFSA) and registered retirement savings plan (RRSP) investors should stay as far away from non-dividend issuing stocks as possible.

Negative free cash flows

Last year, Charlotte's Web reported free cash flows of negative $41.39 million – and this quarter's earnings report did not demonstrate much improvement. Last quarter, Charlotte's Web cash flows decreased by almost $116 million.

Free cash flows are a good way of gauging whether the company can share some profits with investors. If a company reports negative cash flows, it is more than likely a sign that shareholders should not expect much in the way of future dividends. Thus, negative free cash flows are a sign that an equity investment in the company is not the right market move.

High debt burdens

In the case of Charlotte's Web, the company does not have much debt to report. This is good news for investors. Low debt means that the company does not pay much in interest and lessens the likelihood of bearish price performance that typically accompanies highly leveraged stocks. But, should long-term investors trust a stock based solely on low debt levels?

The answer is undeniably, "No." Low debt levels could indicate several different problems. Maybe lenders consider the company too risky. In that case, equity is also too dangerous for long-term shareholders. Because Charlotte's Web failed to pass the test based on dividend yield and free cash flows, the low debt levels fail to provide much reason to trust the stock to offer liquid returns.

Foolish takeaway

Long-term shareholders like those investing for retirement need to look at multiple measures of profitability and performance before making share purchases in a bear market. Bear markets are a great time for long-term investors to find underpriced stocks and profit on the fear and volatility created by short-term speculators.

Nevertheless, these decisions need to be made cautiously by analyzing three complementary performance indicators: dividends, cash flows, and debt levels.

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