3 Stocks to Avoid in a Volatile Market

Description

The stock market is always volatile. It's normal to see it moving up or down 1-3% in one trading day. However, the market can get above-average volatile when there's increased uncertainty, such as the trade talks between the United States and China with good or bad news popping up here and there, or when the oil prices go up or down significantly in a short time.

Three types of stocks can experience much greater volatility than the volatile market: ultra high growth stocks, cyclical stocks, and small-cap stocks.

Ultra high growth stocks

Often, ultra high growth stocks are characterized by underlying businesses with incredible revenue growth but aren't necessarily profitable yet. These stocks are more speculative than the average stock.

For example, ***TMX*** *Money* recently pointed out that **Canopy Growth** (TSX:WEED)(NYSE:CGC) was the top growth stock on the **Toronto Stock Exchange** over the last three years. It showed that the top performer rose more than 1,800% in the period!

However, after crashing more than 50% from its high, WEED stock has only appreciated by more than 500% from three years ago.

WEED data by YCharts. The three-year price action of Canopy Growth stock on the Toronto Stock Exchange.

Canopy Growth's three-year revenue growth rate is 1,680%, while its revenue is nearly three times that of a year ago. As the company grows larger, it's going to be harder and harder for it to increase its revenue at a high rate.

Canopy Growth has also been operating at greater losses over time. In fiscal 2016, it reported a net loss that was nearly 28% of revenue. In the last fiscal year, it reported a net loss that was three times of revenue! The trailing 12-month numbers indicated a net loss that was nearly 6.5 times of revenue!

That said, [the worst may be over for Canopy Growth](). Last quarter, the company explained that it experienced a lower margin largely from operating costs related to facilities that haven't begun production yet. So, WEED's gross margin should rebound meaningfully in subsequent quarters.

Cyclical stocks

Cyclical stocks are impacted by the booms and busts of economic cycles. When the economy is growing, they tend to do well. When the economy is faltering, they tend to do poorly. Examples of cyclical industries include car manufacturers, airlines, and construction.

Small-cap stocks

The share prices of small-cap stocks can be easily manipulated from the smallest of news because of the small sizes of their market capitalization rates. Therefore, when the market increases in volatility, small-cap stocks can be greatly affected.

Foolish takeaway

We're at or near a late economic cycle. Investors may therefore opt to limit their exposures to ultra high growth stocks, cyclical stocks, and small-cap stocks with the aim of greatly reducing the volatility of their portfolios.

If you have little to no exposure to these three types of stocks in the next market downturn, you should experience a much smaller draw-down in your stock portfolio.

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