2 Consumer Cyclical Stocks to Avoid at All Costs in 2020

Description

Consumer cyclicals are some of the most important stocks you'll want to avoid ahead of a slowdown in the economy. When the economy slows and income levels fall, for most consumers, debt repayments becomes the number one priority.

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Especially here in Canada, as consumer debt has been growing at an incredibly fast pace over the last decade, eventually the levels of debt are going to have to revert back to the norm.

When this happens, consumers will have to sacrifice items they currently spend their discretionary income on, which will impact the companies that sell these discretionary items.

Two stocks to watch that could be most influenced by a reduction in consumer spending are **Linamar** (TSX:LNR) and **MTY Food Group** (TSX:MTY).

Linamar

Linamar is a stock that may look cheap to most investors, but it has been priced that way for a reason by the market.

It's the world's second-largest auto parts maker and is divided into two main divisions: powertrain and industrial.

The stock has a price-to-earnings ratio of just six times, but that's based on its past performance.

Going forward, I think most investors expect the auto industry, which has seen record highs and growth the last half decade to decline slightly, which the market is worrying will affect the auto parts makers significantly.

Linamar is still highly exposed to internal combustion engine vehicles, and although it is planning to grow its components that are in hybrids and fully electric vehicles, that portion of its business still lags behind by a large margin.

Although the company is very well run and is an excellent stock when the auto industry is in expansion, it could be at risk of increasing industry headwinds, which is why investors should proceed with caution.

It also doesn't help when companies go on strike and plants shut down production for an extended period, which is becoming more of a trend lately, as that obviously impacts its sales as well.

Going forward, it will be interesting to see the trend that global auto sales takes, especially as we enter a period of global growth slowing down.

MTY Food Group

MTY Food group owns a host of quick-service restaurant brands that it either owns and operates or franchises. In total, it has 80 brands and operates in both Canada and the United States, with just 5% of its sales coming from international operations outside the two countries.

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Although its revenue has been growing consistently over the years, as it has acquired a number of brands, its same-store sales have actually been negative in every year since 2015.

This is not a good sign, especially because same-store sales is one of the top metrics for quick-service restaurants, and if it's acquiring these brands and then seeing a decrease in sales, it's almost certain it overpaid for the acquisitions.

Going forward, this will be the biggest concern for both the company and investors, as a number of its restaurant peers have been seeing the same trend, which is only logical when you consider consumption levels are going to have to level off or even fall to see consumer debt decrease back to the long-term average rates.

The company's earnings before interest, taxes, depreciation, and amortization is being driven by the franchising segment, which is worrisome, because if some of its restaurants go out of business or close down, that could be a big impact on its pool of companies and the earnings it generates from it.

Bottom line

Any consumer discretionary stock will face increased headwinds, as consumers slow their spending, so it's important to understand what companies you own and what the individual economic risks they face to avoid a major catastrophe in your portfolio.

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2. TSX:MTY (MTY Food Group)

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