What to Avoid Buying in This Circuit-Breaking Market Crash

Description

If your powder is dry and you've got more than enough of an emergency fund, now may prove to be a smart time to start placing bets in the defensive, more opportunistic areas of the market. But don't invest with the expectation that the coronavirus to disappear overnight and don't exhaust your cash reserves at any one moment.

Invest with an expectation that the pandemic could drag on for many more months. And be wary of the "cheap" stocks that are too economically sensitive because we're almost guaranteed to be dealt with a severe recession or even a depression at this juncture.

Many Tax-Free Savings Accounts (TFSA) investors have seen the value of their portfolios drop by an average of 35% over the last few months. And those Canadians who bought the dip with their 2020 TFSA contribution have probably been hit with abrupt losses that will likely continue to accelerate.

As the economic damage from the coronavirus crisis (COVID-19) continues to mount over the coming weeks and months, investors may want to proceed cautiously and be *very* picky with where they're choosing to invest.

This piece will review what to avoid as we enter tough times that could have the potential to be scarier than the 2008 Financial Crisis.

Avoid overly cyclical companies

While the **TSX Index** looks to be littered with value stocks, even if the coronavirus were to be cured within the next few months, we're still going to need to deal with the economic aftermath.

We're on the cusp of a potentially severe recession (if we're not already in one already), and all the cyclical companies whose stocks have single-digit P/E multiples could prove to be value traps that could have much further to fall.

Cyclical companies are poised to suffer from substantial multiple expansion as sales and profits fall off a cliff. So, many of the valuations on such names are too good to be true, and the dividends potentially too large to be sustainable.

Magna International is an example of such a “cheap” stock based on traditional valuation metrics with its 4.5 trailing P/E multiple.

Still, as an auto part maker, it’s a highly cyclical play that could stand to take double or triple damage in the event of a severe recession. And just because its stock is “cheap” doesn’t mean it can’t become a heck of a lot cheaper, as demand looks to fall off a potentially steep cliff.

Avoid stressed balance sheets

Nobody knows how long this pandemic will drag on or how bad the recession (or depression) is going to get. As such, you should avoid businesses that are either deep in debt or have very high fixed expenses.

Liquidity is drying up, and many financially strapped firms may not be able to survive through these dark times without a miracle. So, think twice about that 2 P/E ratio if you’re looking at a company with a tonne of debt weighing down its balance sheet without the means to generate sufficient cash flows.

Foolish takeaway

There are many value plays on the **TSX Index** right now. But there are also plenty of value traps, so pick your spots carefully and don’t be drawn into some of the riskier parts of the market, as even the “cheapest” stock in the world can become cheaper. And P/E multiples can expand drastically or become non-existent as profitability plunges in the face of a recession.

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Date
2025/08/26
Date Created
2020/03/23
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