Market Crash 2020: 3 Reasons Why Stocks Could Plunge Again

Description

Although I'm generally a market optimist, I'm the first to admit that many bearish investors have solid reasoning behind their predictions. After all, market crashes happens for a reason, and the headwinds impacting the economy haven't disappeared.

Yes, the **TSX Composite Index** has rallied nicely off March lows, but that doesn't mean a thing. In fact, Canada's benchmark stock index has been quietly weak for weeks now, not really making up much ground. It's entirely possible that TSX stocks could plunge again if we don't get any good news.

Here are three important reasons why you'll want to be cautious for the next little while.

An uneven index

One of the dirty little secrets of this current market crash is although the TSX has rallied off the bottom, many underlying companies still haven't.

Multiple sectors still look incredibly vulnerable right now; pretty much every commercial real estate stock has been hammered, and assisted living stocks haven't fared much better. Many retail stocks are still depressed too.

Other sectors are still feeling the impact of COVID-19. Both banks and insurance company shares are down 20-50%. The energy sector might be permanently impaired, with many names flirting with bankruptcy. And many top restaurants will have a lot of work to do before recovering.

With this much bad news out there, why has the overall index rallied nicely over the last few weeks?

The **TSX Composite Index** recovery is being driven by a few different factors. Gold stocks are ripping higher as inflation fears lead investors to embrace the yellow metal. Nearly every mining stock is performing well today, and grocery stocks have also been strong.

But perhaps the biggest influence on the TSX Composite Index has been **Shopify**. The tech giant has rocketed higher as consumer spending shifts online. It recently became the most valuable company in Canada, which has historically been an ominous sign.

If these sectors turn negative, it's bad news for Canadian stocks. They're propping up the whole market.

A second wave

As it stands today, it appears that investors are pricing in rapid recovery from our self-imposed recession.

It appears that social distancing and self-isolation measures are working. Efforts to flatten the curve have paid off, and apart from a few areas, there haven't been huge spikes in cases or deaths. People are optimistic life will start to return to normal soon, and stocks have priced in those expectations.

But what happens if we get a second wave and we have to go through this all over again?

It's easy to see investors turning incredibly bearish in such a scenario, dumping stocks quickly to protect capital. A second wave would also be devastating to the economy and could push stocks down even lower.

The fallout

Even if we don't get a second wave and COVID-19 quietly goes away, we could still get another market crash if the economy doesn't recover as expected.

The fact is thousands of small businesses need a swift recovery to survive. If that doesn't happen, then temporarily laid-off employees now face a more dire future, putting millions of Canadians close to economic peril.

The ripple effects get worse from there. These folks can't pay their rent, with impacts landlords. Investment property owners can't afford their mortgages, which impacts the bank. The bank's profits go down, which impacts shareholders.

The bottom line

A lot of things have to go right to avoid another market crash, and I'm not sure it'll happen. We could easily see another downturn.

This is why investors should take a few steps to protect themselves today. Keep a healthy cash balance that can be put to work. Diversify into some more stable investments.

And perhaps most important: make sure your personal finances are in order.

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