



Could This Be the Start of Another Bear Market?

Description

A bear market is difficult to predict. Much like the animal itself, bear markets leap out of nowhere and cause chaos remarkably quickly. The most recent one was only four weeks long, when the stock market fell 37% between February and March.

Since then, stocks have bounced back handsomely. Year to date, the market is down just 10%. However, the underlying economy has shrunk far more than 10%. There's clearly a divergence in stock prices and the strength of the nation's economy.

Yesterday, that divergence narrowed slightly. The **S&P/TSX composite index** closed down 650.41 points at 15,050.92 after dropping 132.41 points on Thursday for a loss of more than 4%.

South of the border, the **S&P 500** had its worst day since March. The index slumped 5.9% on Thursday, with only one out of 500 stocks ending the day in positive territory.

Investors should probably consider if this is the start of a new bear market.

Technical bear market

Technically, a 20% decline in the index is considered the start of a bear market. The all-time high for the TSX index was 17,944 on February 20. With that in mind, the TSX index would have to lose another 956 points to re-enter a technical bear market, which at this stage seems highly likely.

To estimate where the index could be in a few months, it's important to take a closer look at the most critical sectors on the index: technology, energy and financials.

Technology outlook

Technology has quickly emerged as a critical segment of the index. **Shopify** is now the largest company in the country and the heaviest weighted stock on the TSX Index. The price performance of Shopify stock could be the most important driver of the index for the rest of the year.

Unfortunately, Shopify's stroke of good luck seems to be running out. Demand for online shopping surged in recent months as Canadians remained confined to their homes. However, the economy and shops are now gradually opening up across the country.

While the online shopping won't decline suddenly, the recent spurt could have pulled forward future growth to the present.

That means Shopify's growth numbers may not be as impressive going forward as its most recent quarters. Meanwhile, the stock trades at near-perfection. The price-to-sales ratio is 50, while the stock is at an all-time high. In other words, growth in technology may have been tapped out for the moment.

Energy outlook

The price of crude oil has recovered from negative territory to something more practical. A barrel of the black goo now trades at US\$33.56. Production cuts in the Middle East might put a floor on that price, which means it won't go much lower.

However, a sluggish global economy and widespread lockdowns put a ceiling on the price as well, which means the price won't surge suddenly either.

Canada's energy sector, once its most critical, is stuck in limbo. Energy stocks such as **Enbridge**, the fourth-largest stock on the TSX Index, and TC Energy, the ninth-largest stock on the TSX Index, may be range-bound for a while.

Financials outlook

Finally, the biggest sector on the TSX index is banking and financials. Four of the largest banks and investment companies in Canada collectively occupy 28% of the Index.

This sector is on the verge of immense pain. For the past few months, the government has stepped in to provide economic relief to Canadian households. Banks, meanwhile, have offered mortgage deferrals to homeowners. All these programs are crucial, albeit temporary.

When the government withdraws cash relief and the six-month mortgage deferrals end, financial companies could take a hit.

I expect the number of delinquencies and corporate defaults to spike in the second half of the year. If there's [another wave of COVID-19 infections](#) and the country re-enters a lockdown, the pain could be further magnified. I can't even imagine what that would do to the housing market and bank balance sheets.

In other words, Canada's largest sector is its most vulnerable, which could be a clear indicator of another bear market ahead.

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