This Is 1 of the Cheapest Stocks on the TSX, But Is it a Value Trap?

Description

There's no question value investors and those looking to buy **TSX** stocks as cheap as possible are using one of the best long-term investing strategies.

If you can find a high-quality business that's trading below its true or intrinsic value, then almost always, barring some major black swan event, that stock should revert at least back to its value in the long run.

This is the strategy that Warren Buffett has made famous over the years. The strategy works by buying the most undervalued companies you can find. This gives you a significant margin of safety.

If you're already buying a stock that's undervalued, it's very difficult to lose even more money when most would expect the value to go up.

However, this strategy isn't perfect, and often, despite a TSX stock looking undervalued, it can be what investors call a value trap.

How to tell if TSX stocks are value traps

It's not exactly straightforward to know what a value trap is. The reason they are so difficult and pose risks to investors is because the stocks look super cheap and highly appealing.

Of course, the reason they are this cheap is because they have been priced this way by the market, and the major discount that exists usually represents the probability of bad news happening.

Often, one of the tell-tale signs of a value trap is a TSX stock price or valuation multiple that seems too good to be true. That doesn't mean that you should dismiss these investments right away. However, the cheaper the stock, the more research you should do into why it's so cheap.

During this process, it’s important to not only look at the company today and its future but also its past to get a good idea of what’s made it successful before.

There’s a strong chance that the reason it’s struggling today is because of a new development in the industry or new competition entering the market.

One super-cheap TSX stock

One of the cheapest stocks on the TSX today is the casino operator **Gamehost** (TSX:GH).

Gamehost owns three casinos in Alberta as well as hotels at its Grande Prairie and Calgary locations. While this industry isn’t maturing, it is facing problems in our current environment.

For starters, the first issue with Gamehost is its lack of geographic diversification. All of the properties owned by the TSX stock are in Alberta.

So, although casinos have nothing to do with oil, the state of the oil industry has a major effect on Alberta’s economy and, therefore, Gamehost’s earnings.

This has been a considerable problem since 2015, the last time the oil markets crashed. However, the problems are being made much worse by the ongoing coronavirus pandemic.

With casinos and hotels being one of the most heavily impacted industries, Gamehost has some major headwinds ahead.

And although the stock has put up respectable results in adverse conditions over the last few years, there are some things that it can’t control.

Gamehost could be a steal at these prices. It’s especially cheap today if the economy can rebound faster than expected. But if this pandemic and the underlying economic consequences drag on, Gamehost stock could be one of the biggest value traps on the TSX.

Bottom line

Buying TSX stocks that are trading below their fair value is one of the best strategies. However, it will only work if the companies are high quality to begin with.

So, make sure you have a full understanding of a business and its industry before you invest. Otherwise, you may be buying into a value trap.

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