These 2 TSX Stocks Are Too Risky to Buy in July

Description

The stock market is known for wealth creation as well as wealth reduction. Billionaire investor Warren Buffett's **Berkshire Hathaway** reported a total investment loss of US$54.5 billion in the first quarter compared to its investment gain of US$56.3 billion in the previous year's quarter. This loss came as its investments fell in March when the COVID-19 pandemic created a panic sell-off in the stock market. The trick is not to panic and stay invested in stocks that have strong fundamentals and growth potential during an economic upturn. However, it is also important to avoid high-risk stocks that can take away your wealth.

Stocks that are too risky to buy

High risk indeed rewards investors with higher returns. But a loss-making company with massive debt is a risk you want to avoid, especially in an economic downturn. Even if the ailing company sees the end of the tunnel of weak demand and mounting losses, it could collapse during the recovery. When the demand returns, it will be left with massive debt and little cash to profit from the sales. One such company is **Air Canada** (TSX:AC).

Air Canada

The pandemic-driven lockdown has grounded 90% of AC's capacity, and the airline is burning cash just to stay afloat. It is set to report its most significant quarterly loss of over $2 billion in the second quarter after reporting more than five straight years of profits. The company is even funding its loss with debt, which could lead to financial distress and ultimately, bankruptcy. Fitch Ratings has downgraded AC's long-term debt to BB-, which indicates a risk of default in adverse economic conditions. Even if air travel demand returns, it will take AC at least three to five years to break even.

AC stock is down 67% year to date at $16.7. But even at this price, it has a very high valuation of 57 times its earnings per share. Since the March sell-off, the stock has been trading between $16 and $20, as traders are speculating on any positive news. For instance, airlines stocks jumped earlier this month due to an uptick in air travel demand. AC stock jumped 42% in just one week but then fell 23%

in the next three days, as traders cashed out their profits.

The future of AC stock is cloudy. Its stock price could either fall to $0 or normalize at $30. If you buy $1,000 worth of AC stock now, you could either earn around $500 or lose the entire $1,000 over the next one or two years.

Stocks that are too risky to buy in July

Other than companies that have huge debt, there are high-growth companies with inflated investor expectations. If their earnings fail to meet investors' expectations, their stock price could see a steep decline. The software-as-a-service (SaaS) industry is home to many such high-growth companies, like **Shopify** (TSX:SHOP)(NYSE:SHOP).

The SaaS business model has a low capital requirement, which crowds the space with too many companies offering similar services. The most crucial stage for a SaaS company is the high-growth stage, when it spends a significant amount on customer acquisition. If it succeeds in retaining a substantial chunk of these customers for a longer term, it can recover the cost of acquiring new customers and generate profits.

Shopify

The e-commerce platform provider Shopify, founded in 2004, started trading on the Toronto Stock Exchange in 2015. The company is in its high-growth stage, with a revenue CAGR of 50% between 2015 and 2019. However, most of this revenue is from new customers, because of which it has not yet started generating any profits.

Despite the losses, Shopify stock is trading above $1,200, which is 87 times its sales per share. The stock more than doubled in three months, as many retailers and customers switched to e-commerce during the lockdown. The inflated stock price has limited its upside potential. In June, the stock dropped 18% in the first half and then rose 27% in the second half. While the pandemic has created a conducive growth environment for Shopify, investors have priced the sales growth for the next 10 years, making it too risky to buy in July.

Be careful while taking risks. This July, avoid stocks with high leverage and inflated stock prices.

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Date
2025/08/27
Date Created
2020/06/29
Author
pujatayal