Stock Market Crash: Was Q2 Market Rally a Trap?

Description

Today, nearly all mainstream media outlets are highlighting that Q2 was the best quarter for the **S&P/TSX Composite Index** since 2009. However, solely looking at the second quarter market rally — without taking the first quarter massive sell-off into account — doesn't make much sense to me. In the second quarter, the index rose by 16% after losing 21.6% in the first quarter.

Let's try to understand what happened in the first half of 2020 — and how it could be pointing toward an upcoming market crash in the near term.

Uncertainties remain

Overall, the first half of 2020 was disastrous for many industries across the globe, including the airline and automobile sectors. The COVID-19 outbreak — which spread out across the world after originating in China earlier this year — took a big toll on investors' sentiments.

While the virus seems to be under control in China — for now — many countries are still battling to come back to normal and reopen their economies. For example, the U.S. reported more than 47,000 new COVID-19 cases on June 30 — their highest number of infections in a single day.

Many investors seem to be ignoring the fact that the companies are yet to start reporting the full negative impact of the pandemic on their business and their future growth plans. Some would argue that the full negative impact of the pandemic has already been discounted in the stock market. If that's true, we wouldn't have seen such a massive rally in the second quarter, which was overdone.

The worst is yet to come

Canada's gross domestic product fell by 11.6% in April, albeit it's expected to rise by 3% in May. However, the future remains uncertain. Hundreds of thousands of people have lost their jobs, which eventually will affect their purchasing power as a consumer. The government can't continue to fill the pockets of the needy people with some extra cash forever.

During a G7 leader's meeting in mid-April, Prime Minister Justin Trudeau highlighted the importance of carefully managing the reopening of the global economy to prevent a second wave of COVID-19 infections. His fears about the second wave seem to be coming true now for many countries.

Even if we agree that the pandemic has already subsided, we are yet to learn how a possible post-pandemic shift in consumer behaviour is likely to force companies to transform their businesses. And to be honest, many businesses — which don't have a very strong balance sheet for such transformation efforts — may struggle to survive and even collapse in the post-pandemic world.

All these reasons seem to be pointing toward an upcoming big market crash in the near term. However, it won't be easy to predict the exact timing of an upcoming crash. Whether it will take place in Q3 or Q4 completely depends on how long investors continue to ignore the pandemic's real impact on the global economy.

What should you do?

Nonetheless, some businesses have seen solid tailwinds due to the pandemic. **Shopify** (TSX:SHOP)(NYSE:SHOP) is one of such Canadian companies. Since the pandemic started, the company has managed to attract many small businesses who want to either start or improve their online presence.

As a result, Shopify's revenue rose by 46.7% in the first quarter, and the company's adjusted earnings more than doubled to US$0.19 per share. Its first-quarter earnings also surprised many Wall Street analysts who were expecting the company to report adjusted net loss of US$0.18 per share.

Shopify's stock has already risen by about 150% this year so far. I would recommend buying its stock — on dips — only to investors with good risk appetite.

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