Warning: The Stock Market Is Unreasonably Overvalued and Poised for a Crash

Description

The recent uptick in equity markets makes little economic sense. While the bulls will argue that the stock market is forward looking and the worst is (hopefully) behind us, there are several red flags that might come back to haunt investors.

The S&P/TSX Index is down 7% year to date, which indicates a market cap of $2.7 trillion. Comparatively, Canada's GDP (gross domestic product) in 2019 stood at US$1.74 trillion, according to data from *Trading Economics*. Further, its GDP might contract to US$1.65 trillion in 2020, which means the stock market is overvalued by 20%, according to the Warren Buffett indicator.

It is unlikely that the economy will kickstart and recover to pre-COVID-19 levels by the end of this year. Unemployment rates have surged higher, which has drastically reduced consumer spending and consumption.

Further, there is a huge threat of a second wave of the coronavirus that might completely decimate the stock markets. If lockdown restrictions are levied again, the Canadian economy will take a devastating blow.

Canadians were already grappling with high debt levels way before the ongoing crisis. Now, millions have applied for mortgage deferrals, and if the crisis continues, the economy will suffer from related headwinds. If mortgage default rates rise, several other sectors including banking and real estate, will also take a massive hit.

How do you play an overvalued market?

So, does this mean you need to sell all your investments, exit the equity market, and wait for the market to bottom out? The answer is a big NO. It is almost impossible to time the markets, and only a handful of investors who sold their positions before the crash of 2020 would have successfully managed to buy the market bottom in March.

Instead, you can keep some cash aside and buy quality stocks such as **Algonquin Power & Utilities** (TSX:AQN

)(NYSE:AQN) stock at a lower valuation. Algonquin is a renewable energy and regulated utility company with $10 billion of assets across North America. It provides natural gas, water, and electricity generation, transmission, and distribution utility services to 805,000 customers in the U.S. and Canada.

Over 60% of the company's business is rate regulated, which means government regulators decide Algonquin's profit margins for its utility services. While it is not ideal, a rate-regulated business generates predictable revenue streams, as pricing is determined in advance in most cases by several years.

Algonquin continues to reinvest its earnings into expanding its renewable energy portfolio that accounts for 33% of its total portfolio.

In the first quarter of 2020, the company's adjusted EBITDA was up 5% year over year at $242.2 million, while earnings per share were flat at $0.19. It increased annual dividends by 10%, marking Algonquin's 10th consecutive year of dividend growth. Algonquin stock is currently trading at $18.42, which is 16% below its 52-week high. This pullback has increased its forward yield to 4.6%.

Algonquin is just an example of a quality utility company that can increase its dividends over time and increase investor wealth multi-fold, as it looks to increase its presence in the high-growth renewable energy space.

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