



Is There a Tech Bubble That Could Burst in 2020?

Description

The recovery from the [2020 coronavirus market crash](#) is nothing short of unprecedented. If you held your nose and just did some buying in the second quarter, you likely did well, as the broader markets went on to post a V-shaped recovery.

Today, the **S&P 500** and **TSX Index** are both down 4% and 10%, respectively, from their pre-pandemic heights. Meanwhile, the tech-heavy **NASDAQ Composite** is at a fresh all-time high, up a whopping 9% above those February 19 heights, as tech stocks have led the upward charge.

Many folks have been bringing into question the divergence between the stock market and the economy lately. But what about the divergence in performance between the tech-heavy NASDAQ and other indices?

There's no question that the recent rally in tech stocks rhymes with the lead-up to the tech bubble that burst in 2000, but is the tech sector really in a bubble? Or are the lofty valuations warranted given the stock market is pointing to a nice economic recovery that could be in the cards in 2021?

Is there a tech bubble that could burst in 2020?

Probably not.

While the recent tech-driven rally may be of concern to those who invested through the dot-com bust, tech stock valuations, in aggregate, aren't at the absurd levels they were in 1999. So, no tech stocks aren't partying like it's 1999. At least, not yet.

However, I do see pockets of severe overvaluation within the tech sector that are quite pronounced. For instance, the cloud stocks that have been riding high on pandemic tailwinds are looking dangerously frothy at this juncture.

Some of the biggest tech winners over the past quarter now see themselves up well over 100% over the last few months. Others have more than tripled. And their valuations are now above and beyond

that of their historical averages. While pandemic tailwinds are undoubtedly worth a premium, I'm in the belief that many momentum chasers looking to the hottest tech stocks today are in danger of paying up for many years worth of growth right off the bat.

Growth investors: Valuation *always* matters

I don't care if you're looking at the best business in the world with the strongest tailwinds at any given instance. If the price paid is too high, you could stand to lose a considerable amount of your hard-earned investment dollars.

That's why I'd encourage investors to always consider the valuation of a stock they're looking to purchase, rather than letting emotions like the fear of missing out force you to buy at a stock at whatever price Mr. Market asks.

One has to draw a line somewhere, and with some of the hottest stocks out there like **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)), I think there's a chance that the line has been crossed and that investors looking to buy after the stock's unprecedented bounce could put themselves at risk of feeling the full force of a correction sparked by a broader correction in tech stocks.

Sure, tech-driven growth is one of the few places that have been [working](#) amid the pandemic. And while I've been pounding the table on shares of Shopify over the past few months, I'm growing reluctant to recommend the name at these heights.

Shopify has had its fair share of plunges en route to \$1,400, not because the company fundamentals have decayed, but because the stock needed a chance to take a breather.

The tech stocks riding high on pandemic tailwinds are overdue for a mild correction in the event of a broader growth-to-value rotation. So, if you doubled up on shares of Shopify over the last few months, can it hurt to take your principal off the table, as you look to play with the house's money? I'd say it's only prudent, as tech valuations continue swelling at a quicker rate than most other stocks.

Foolish takeaway

Don't get me wrong. Shopify is a wonderful business — an e-commerce kingpin that's a force to be reckoned with. The company is firing on all cylinders under its unstoppable founder Tobias Lütke, but the valuation has become stretched.

Although I don't see a tech bubble, I do think the hottest tech flyers are at a high risk of correcting in favour of neglected value stocks.

CATEGORY

1. Coronavirus
2. Tech Stocks

TICKERS GLOBAL

1. NYSE:SHOP (Shopify Inc.)

2. TSX:SHOP (Shopify Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
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Date

2025/08/23

Date Created

2020/07/22

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