Undervaluation + Momentum: A Bargain That Just Corrected 54% to the Upside

Description

When you hear of a correction, you're probably thinking of the traditional definition: a 10% decline in a stock. What many beginner investors may not know is that corrections can go both ways. If the reality of the situation is discovered to be better than what Mr. Market was initially thinking, a correction to the upside may be in order.

Now, like a downward correction, upside corrections can take some time to play out. A market mispricing may go unnoticed for months, if not years. As such, value investors seeking to buy an overly battered stock for a chance at profiting in an upside correction should remain patient, despite near-term noise that stands to take out all but the most strong-handed of investors.

With the TSX Index inching closer towards fully recovering from the COVID-19 sell-off, many pundits have been questioning the sustainability of the rally given the divergence between the real economy and the stock market. Some bears think that it's just the U.S. Fed that's keeping stock prices afloat. And while the "Fed put" is a huge reason why the broader markets have enjoyed an unprecedented rally over the last few months, it would be wise for investors to take near-term market projections from anyone with a very fine grain of salt.

Many investors learned the hard way that it's pointless to attempt to time the markets earlier this year. If you followed the herd out of stocks amid the panic-driven rush to cash, you likely got hurt. Timing the markets or subscribing to a random pundit's market forecast can be harmful to your wealth. So, instead of wasting your time with trying to predict where the markets are going next, buy shares of businesses that you believe are priced at a discount to either intrinsic value or are discounted on a relative basis. That way, you'll do well over time, regardless of what Mr. Market will throw your way next.

Undervaluation and momentum? Look no further than this battered insurance play

Consider **IA Financial** (TSX:IAG), a severely undervalued non-bank financial that looks like a wise bet right now, despite COVID-19 headwinds or the "frothy" nature of the broader markets. Shares recently popped 7.7% on Thursday following second-quarter numbers that were much better than expected.

The Canadian insurer and wealth manager clocked in $1.57 in core EPS for the quarter, down just 6% on a year-over-year basis in spite of COVID-19 disruptions and blowing away the consensus, which called for $1.38 per share. Even after the big single-day pop, IA Financial stock still looks severely undervalued. As I mentioned in prior pieces, IA Financial may not have the largest dividend in the Canadian insurance space (a mere 4% yield), but what its dividend lacked in size it made up for in quality, as IA has typically commanded a far lower payout ratio than some of its peers that “overextended” themselves with larger dividend commitments.

I think the Q2 post-earnings pop is the start of what could be a sustained rally higher for shares of the battered insurer. At the time of writing, IAG stock trades at 0.85 times book value and 7.9 times next year’s expected earnings, both of which are a country mile below that of the stock’s historical averages.

Foolish takeaway

While the dividend leaves a lot to be desired, the valuation to be had today, I believe, makes the name a must-buy for those looking for the best bang for their buck at today’s market crossroads. Shares are now up 54% from their March lows but are still down over 36% from pre-pandemic heights.

As IA Financial continues shrugging off pandemic headwinds, it’s likely the top-tier insurer will pick up where it left off prior to the crisis and think that a further correction to the upside may be in the cards over the next year or so.

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