Shopify (TSX: SHOP) Is Overvalued With Declining Trade Volume: Time to Sell?

Description

In 2020 so far, **Shopify** (TSX:SHOP)(NYSE:SHOP) stock has been on fire. After registering a minor 5.4% loss in March, the stock saw a steep rally in the following four months. A massive jump in the company's new store creation rate — amid COVID-19 crisis — boosted investors' confidence and drove its future earnings estimates higher. As a result, Shopify stock has yielded nearly 160% positive returns this year.

Let's discuss whether the stock is still worth holding despite its massive year-to-date gains.

Shopify stock: declining trade volume

While Shopify stock is still maintaining its top position among **TSX60** gainers in 2020, its stock rally seems to be losing steam lately. The stock has lost about 1.7% this month so far as of August 24.

Shopify's monthly trade volume on **TSX** also has declined significantly in the last few months. Interestingly, the e-commerce giant had seven billion shares of trade volume in May 2020 and has been consistently falling since then. In August, the trade volume has fallen to $2.4 billion shares on a month-to-date basis.

Consistent declines in trade volume with rising stock prices could be pointing toward an exhausted uptrend in Shopify stock, I believe. This is the first reason why you may want to book partial profit if you hold Shopify's shares right now.

Shopify stock is overvalued

Currently, Shopify stock is trading with 621 times its earnings and over 1,000 times its cash flow for the trailing 12 months — significantly higher than the industry average. With such extraordinarily high valuation multiples, even bulls can't deny the fact that the stock is way overvalued.

Out of eight Bay Street analysts covering Shopify, six recommend buying its stock. Their consensus price target for the company is $709.88 right now. But the stock currently is trading at $1346 per share on **TSX** — nearly double the analysts' consensus price target.

Best could already be over

In Q2, Shopify's total revenue rose by 39.2% year over year. In the last couple of quarters, the company has hugely benefited from small businesses' rising interest in building or strengthening their online presence — using Shopify's e-commerce platform — due to COVID-19 related closures.

I don't deny that Shopify's fundamentals look very strong at the moment. But these strong fundamentals, along with its future growth estimates don't necessarily justify its extremely high stock price.

As I pointed out in my recent article, the best might already be over for the company. It's very likely to face a sequential decline in its key growth metrics, including in the new store creation growth rate as the pandemic subsides.

Should you sell Shopify?

No matter how many factors are confirming that the Shopify stock is overvalued, I wouldn't recommend short selling Shopify stock, as it's still in a strong uptrend. Even if you strongly believe that the stock is way overvalued, investors' forward-looking irrational expectations might continue to fuel this rally.

However, if you bought Shopify stock to realize short to medium-term gains, it could be the best time to at least book partial profit by selling some of its stocks that you already own.

The declining trade volume, along with overvalued share price, could be an early indication of a trend reversal or an upcoming major downside correction in Shopify stock.

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