2020 Market Crash: Could the Next Sell-Off Be Just As Vicious?

Description

The February-March 2020 market crash was nothing short of unprecedented. The novel coronavirus was spreading rapidly in mid-February, but the stock market had seemed to have shrugged off concerns over the virus's potential to cause a pandemic. Indeed, the stock market was much like Wile E. Coyote in February. Eventually, gravity pulled stocks down, and investors were hit with one of the sharpest market sell-offs in recent memory.

Today, stocks have reversed course again as we move further into what's been a historically bad month for the markets. The **S&P 500 Composite Index** and **NASDAQ** slipped around 6% and 9%, respectively, in just two trading sessions in what appears to be a profound shift out of the first half's biggest tech winners.

Back in July, I warned investors over "pockets of severe overvaluation" that have formed within the hottest areas of the tech sector. Although I didn't think we'd be in for a repeat of the tech bubble burst of 2000, I did warn investors to be wary of momentum stocks, many of which have doubled or tripled in a matter of months.

A momentum cool-down that was a long time coming

"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," I said in a prior piece titled 'Is there a tech bubble that could burst in 2020?

"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."

With tech stocks driving the latest downward charge, many investors who were reluctant to take profits have now surrendered a considerable portion back to Mr. Market. As the negative momentum picks up, there's no question that we could find ourselves back between a correction (10% drop) and bear market territory (20%), as the flock of new retail investors run to the hills, either willingly or forced sales through margin calls.

Things could have the potential to be ugly, but I don't think Foolish investors should overreact, even if we're dealt with further double-digit down days. This tech-driven sell-off, I believe, is healthy and should have been expected given the unprecedented momentum witnessed in the first half's biggest winners.

Yes, pandemic-resilient growth is deserving of a premium amid this crisis, but overshooting the upper bound on valuation was bound to happen eventually, especially given the rise in speculative activity facilitated by commission-free trading platforms.

So, how should you react as the markets crash back to reality?

Stay the course. Ensure your portfolio is balanced with COVID-19 resilient and COVID-hit plays. Trim the frothy off your biggest winners if you've yet to do so and scoop up some of the unfairly-battered bargains that could have the most room to run in the next leg of this rally, which could be driven by "value" stocks that have felt the full force of the COVID-19 impact.

While there's no telling when this sell-off will end, the U.S. Fed is unlikely to step in if it's capped at a correction. The Fed is a great friend to the investor, and Chairman Jay Powell is likely to step in if selling gets as bad as it did back in March. As such, I'd continue buying bargains like **Fortis** on the way down because I don't think this is "the end" as we know it. I believe it's a long-overdue correction and that long-term investors should relish the opportunity to pick up some significant bargains.

This is arguably the most uncertain market environment we've ever found ourselves in. That's bad news for beginner investors who lack a strong stomach. But for prudent long-term thinkers, such unprecedented magnitudes of uncertainty and volatility have paved the way for a less efficient market that vastly improves one's ability to achieve excess risk-adjusted (market-beating) returns.

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