STOCK MARKET: Prepare for a Scary September

Description

Last week, we saw the first major pullback in stocks after several bullish months. On Thursday, the S&P 500 slid more than 3.5%, followed by a more modest decline on Friday. The TSX, too, fell on Thursday and Friday, led by a major selloff in tech stocks.

While last week's movement may have been a blip on the screen, it may also have been something bigger.

September is historically the weakest month for stocks, a fact that has been confirmed by several studies. This year, we're heading into September with an overheated stock market and ongoing economic difficulties. Most likely, it's going to be a tough month. The following are three reasons why.

Tech stocks were getting overheated

Before the recent dip, tech stocks were getting extremely pricey. Stocks like **Apple** and **Tesla** soared to new highs after their splits, only to plunge a few days later. As of this writing, hardly any "big name" tech stocks are cheap. Most of them trade at more than 30 times earnings; some are more than 100 times earnings.

Case in point: **Shopify** (TSX:SHOP)(NYSE:SHOP). Shopify is one of the "hot tech stocks" that led last week's selloff. As of market close Friday, it traded at 77 times sales. Yes, that's *sales*, not earnings. That's an extremely high price-to-sales ratio for a stock to trade at. The stock is also expensive relative to book value, trading for about 32 times book value.

Shopify is just one example among many. Virtually all of the FAANG stocks were historically pricey last week. Partially, that was due to investors pouring money into sectors perceived as "COVID-proof" in the months prior. Tech was seen as a "safe" sector, so it got investor attention. Now, however, the steep valuations are getting too obvious to ignore. And as you're about to see, the economic fundamentals still aren't great.

The economic recovery is real but not *that* good

One of the reasons why stocks spent much of Q2 and Q3 rising is because the economy had been recovering. In April, May and June, Canada and the U.S. both added jobs, and corporate earnings mostly started to recover after their rout in March. However, this recovery hasn't been *that* pronounced. It certainly has not been "V shaped."

As of its most recent jobs report, the U.S. still had a historically high 8.4% unemployment rate. So, while we're seeing positive momentum, things aren't immediately moving back to the pre-COVID status quo.

The U.S. election is coming up

Last but not least, there's the fact that the U.S. election is coming up.

Presidential elections are often thought to have a major impact on stocks, and this year looks like one where that will be true. Both Joe Biden and Donald Trump have pushed policies that would impact economy in significant ways. Trump's protectionist trade policies are bad news for importers, while Biden's proposed corporate tax hike could put a damper on stocks generally.

Depending on how the election plays out, there could be implications for investors. Perhaps some are pulling their money out early to "wait and see what happens."

On that note, the U.S. election is just as important for Canadian investors as for Americans. U.S. economic policy ultimately affects Canada, especially when it comes to things like trade.

Just recently, President Trump slapped a 10% tariff on Canadian aluminum exports. That kind of thing has an impact on Canada's economy and, in turn, its stock market. Also, virtually all U.S. economic policy has an impact on Canadian companies that operate directly in the U.S. or have U.S. subsidiaries — categories that include tech stocks like Shopify, several utility companies, and most of Canada's big banks.

In this environment, you have to prepare for turbulence. That's true whether you're keeping your money in Canadian stocks or have a globally diversified investment portfolio.

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