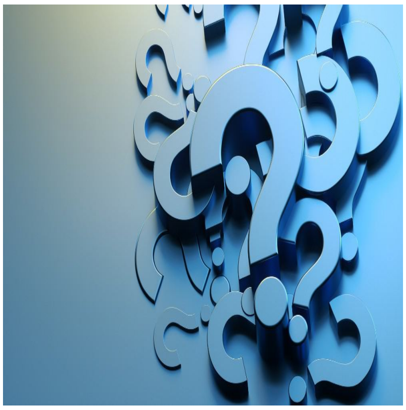

Is the Stock Market Fundamentally Overvalued?

Description

Unlike the tech and IT-heavy U.S. stock market, the bulk of **TSX** weightage is supported by the financial, material, and energy sectors. Out of these two, the materials have been performing exceptionally well, thanks mostly to investor interest in gold and prices rising continually. But the other two sectors have been suffering, especially since the pandemic hit. But the question of the stock market's overvaluation is older than the epidemic.

The crash in March was one of the most significant blows that hit the stock market after the 2008 recession. Since then, there have been ups and downs but never a sharp fall as deep as the one in March. And after the last recession, we've seen a robust market for over a decade. Investor confidence in large-cap companies trading on TSX was one of the major reasons why the stock market became overvalued.

But is the market fundamentally overvalued right now?

Current valuation

Ever since the crash, the market is in a bit of disarray. Relatively fewer companies have reclaimed their pre-pandemic valuations. A large proportion of financial and energy, two out of the three major sectors on TSX, are still struggling. The disparity is pretty obvious if you see the respective indices, i.e., the energy index is still down 47% from its pre-pandemic high, while the financial index is 16.43% down.

Compared to that, the material and tech indices are up 26.5% and almost 30%, respectively, from their pre-pandemic highs. The **S&P/TSX Composite Index** is trading just below 7% of its pre-pandemic high. The fact that two heavyweight sectors are substantially down in the midst of a near-complete market recovery does seem to indicate an overvalued stock market.

And while it may not impact your choice too much when you are picking up individual stocks (since you would be looking into the valuation of the company itself), it does indicate that we might be heading into another market crash.

An oversold stock from an oversold market

One way to capitalize on a market crash is to buy companies that are typically too expensive for you, from a value investment standpoint. One such stock is **Canadian National Railway** (TSX:CNR)(NYSE:CNI)**.** It's not too overpriced, especially for a powerful aristocrat with stellar dividend history and decent capital growth potential, but it's getting there. The stock also showed a decent recovery pace after the pandemic.

Currently, CNR is offering a modest 1.7% yield. But if the stock craters again in the upcoming crash, the yield, along with the valuation, might become a bit more enticing. Its five-year returns (dividend-adjusted) are 108.57%, resulting in a juicy five-year compound annual growth rate (CAGAR) of 15.8%. It has a dominant position in the transportation sector and a strong balance sheet.

Foolish takeaway

Just because the stock market might be overpriced doesn't mean all the stocks are, however. But if you want to buy now and don't wish to wait for a crash that may or may not come, browse through financial, real estate, and energy stocks.

You may find many heavily discounted stocks that are fundamentally strong and will shine again when the economy (not the market) finally recovers.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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