



MARKET CRASH 2.0: Popping the Tech Stock Bubble

Description

The entire stock market is not crashing. A weakened economy from the COVID-19 pandemic poses risks, but we aren't seeing a second market crash. Still, the stock market is warning investors that the party may be over for technology stocks.

Seasoned analysts are speculating on the shocking rise in price-to-sales and book ratios of major technology companies. Andrew Parlin, the founder of an investment advisory firm Washington Peak, wrote about the dangerous market valuations of technology stocks in the *Financial Times* on September 6: "Only at the very top of the dotcom bubble, in March of 2000, can we find a larger percentage of stocks (6.6%) trading in excess of 10 times sales."

Toronto Stock Exchange investors can use the 10 times sales as a benchmark for identifying risky technology stocks in Canada. **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)) and **Kinaxis** ([TSX:KXS](#)) fit this description perfectly. These two growth stocks have price-to-sales ratios over 20.

Shopify

Shopify has been a top moneymaker for investors this year. The market price has risen from a 52-week low of \$372.01 to a high of \$1502. After the recent fall in stock prices on major tech stocks, Shopify traded for \$1250.26 on Wednesday.

Despite the recent decline in market valuation, Shopify is still trading at nearly 60 times sales! That's six times higher than Andrew Parlin's danger threshold of 10 times sales. Investors who own Shopify stock should assess the risks.

A high price-to-sales ratio isn't necessarily a predictor of future price decline. Growth stocks like Shopify typically have higher price-to-sales ratios than other investment options. The primary question is how long it will take Shopify to grow its revenue to meet shareholder expectations of future worth.

It's a question worth considering before you purchase more Shopify stock for your TFSA or RRSP.

Kinaxis

Kinaxis has also done well for technology investors this year. The stock price on Kinaxis rose from a 52-week low of \$77.12 to a high of \$224.98. On Wednesday, the stock sold for around \$192.46 after the fall in market valuations last week.

Like Shopify, Kinaxis stock also has a high price-to-sales ratio. Luckily for Kinaxis shareholders, the price-to-sales ratio is not nearly as high as Shopify. Kinaxis has a price-to-sales ratio of 23.74.

Again, Kinaxis reports a price-to-sales ratio much higher than Andrew Parlin's danger threshold of 10 times sales. Kinaxis is also a growth stock. Thus, the high price-to-sales ratio isn't necessarily a reason to worry or sell your entire position.

Nevertheless, it is worth noting that the high valuation is based primarily on speculation about future growth. Kinaxis may never deliver on these expectations.

Should you sell out of tech stocks?

Whether you should sell out of [tech stocks](#) or not depends on your risk tolerance. High price-to-sales and book ratios are signs of risk. Whether or not you can afford to take the gamble is entirely up to you.

If you are unsure, then there are better ways to make your money work for you. Now might be a better time to start shifting your portfolio into stocks that are still undervalued from the March 2020 stock market crash. These stocks might provide greater long-term returns than some of these already pricey technology stocks.

There are some [great investment options](#) on the TSX still in banking and telecommunications. Companies in these industries wield substantial market power and will still likely be powerful players when you decide to retire. Even better: these stocks issue strong dividends so that you can start earning dependable returns on your investment today.

CATEGORY

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1. Editor's Choice

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2. TSX:KXS (Kinaxis Inc.)
3. TSX:SHOP (Shopify Inc.)

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