Stock Market Crash 2.0: How Do You Play the Stock Market Crash?

Description

The last few trading sessions were driven by sector-wide sell-offs. While the tech sector was hurt the most due to sky-high valuations, several other industries experienced sustained selling pressure as well.

There is a good chance the broader markets will move lower in the next few months considering the economy has been impacted by tepid demand and lower consumer spending. Experts believe the markets are not in sync with the economy and the V-shaped recovery since March is unsustainable.

According to the Warren Buffett indicator, the U.S. markets are trading at a market cap to gross domestic product ratio of 175%, which does not make sense given the sluggish macro environment. During the financial crisis of 2008-09, this ratio fell to 57% south of the border. Further, the unemployment rate right now is far higher compared to 2009.

This means several stocks are trading at lofty valuations and are poised for rapid declines. So, how do you play this stock market crash?

Avoid stocks in high-risk sectors

The COVID-19 pandemic has decimated several companies in the airlines, hospitality, retail, and entertainment sectors. Further, rising unemployment rates and a low-interest-rate environment has also made banking stocks vulnerable right now.

The airline space is in a multi-year downturn and air traffic is expected to reach pre-pandemic levels by 2022. Entertainment and retail outlets such as **Cineplex** are likely to experience lukewarm sales as people will be wary of gathering at public places, despite easing of lockdown restrictions.

Further, investors might be wary of an uptick in default rates coupled with lower profit margins for banking stocks.

Tech stocks will be available at a lower multiple

While it is impossible to time the market, the stock market crash will provide you with an opportunity to buy quality growth stocks at a lower multiple. Currently, companies such as **Shopify**, **Kinaxis**, **Zoom Video,** and **Lightspeed** are trading at unsustainable valuations and should move lower to trade at reasonable multiples.

Growth stocks have the potential to create massive wealth for long-term investors and every major dip should be viewed as a buying opportunity. Companies such as Shopify and LSPD have multiple growth drivers and expanding addressable markets that will push sales higher in the upcoming decade.

However, growth stocks trade at a premium, and as mentioned it will be difficult to time the bottom, which means the recovery in these stocks will be swift as well.

Consider recession-proof stocks and earn dividends

While most stocks will trade at a discount, utility stocks such as **Fortis**, **Emera,** and **TransAlta Renewables** should be part of your shopping list. These companies will continue to pay dividends across business cycles and you can generate a stable stream of recurring income by investing in stocks that have predictable cash flows.

Blue-chip dividend stocks will also help generate wealth via capital appreciation for long-term investors. These companies have a low beta and are low-risk investments even during an economic recession.

The Foolish takeaway

In a nutshell, investors need to identify quality companies with strong balance sheets that can help you grow your investments via capital gains or dividend income. If you are bullish on the Canadian economy, double down on your investment in a stock market crash and buy companies at discounted valuations.

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