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Market Meltdown 2.0: How Beginner Investors Can Protect Themselves

Description

September was never really a good month for investors anyway. The **Nasdaq** just corrected in three days, and while only time will tell if this recent round of selling is over, there are essential lessons for beginner investors to take away if they desire to limit damages in the event of a further meltdown in stock prices.

Nobody will warn you once the party ends

The recent tech-driven rally out of the March lows is nothing short of unprecedented. There's no question that many beginners were chasing the hottest of tech stocks right off last week's cliff, as valuations continued to swell to unsustainable levels.

Like the lead-up to the tech bubble burst of 2000, many folks were not only hungry to make a quick buck, but they were also likely enticed by analyst price target upgrades from left, right, and centre. Sell-side analysts know what they're doing, after all, right? So, why not trust a seasoned veteran and his carefully thought-out financial models?

As many beginners will quickly find out, most sell-side analysts on Wall Street are reluctant to slap a "sell" rating on any given stock. Nobody wants to be that person who ruins the party, after all. And after the recent relief rally, many analysts were tripping over one another to update their inputs and upgrade their price targets on various hot tech stocks after the fact.

Don't chase or you could trip!

Chasing analyst price targets blindly can be dangerous. In the lead-up to the tech bubble burst, many analysts pinned "buy" ratings on some of the frothiest tech stocks that eventually fell off a very steep cliff. While this September tech-driven sell-off is unlikely to be as severe as the 2000 dot-com bust, I think there are still pockets of extreme overvaluation within the "sexiest" areas of tech that have yet to be fully corrected.

Now, I'm not talking about the mega-cap tech titans that are pulling in jaw-dropping amounts of cash flow. I'm talking about white-hot stocks like **Shopify** that are growing so fast that it's difficult to gauge the true valuation. While it may be tougher to value such explosive tech stocks, one must never pay any price that Mr. Market asks, because even the fastest-growing business on the planet can be a sell if the price of admission isn't right.

Over the years, Shopify has been subject to a ridiculous amount of analyst upgrades. And don't think that the consensus will turn negative when the stock is about to peak. Many overly bullish analysts may be enticed to wait until after a pullback-inducing quarter before adjusting their financial model inputs and thus their price targets to the downside.

Foolish takeaway

To avoid feeling the full impact of a valuation-induced correction or crash, investors must look beyond just a price target. One must form their own investment thesis and ensure they're not at risk of paying any price that Mr. Market offers during a FOMO (fear of missing out)-induced melt-up.

Many beginner investors learned the hard way that blindly chasing momentum, short-term gains, and price targets is an endeavour that can quickly end in tears. As the September sell-off continues, investors should learn from their mistakes by taking profits on huge winners while they can and ensuring proper sector-wide portfolio diversification to limit their downside.

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