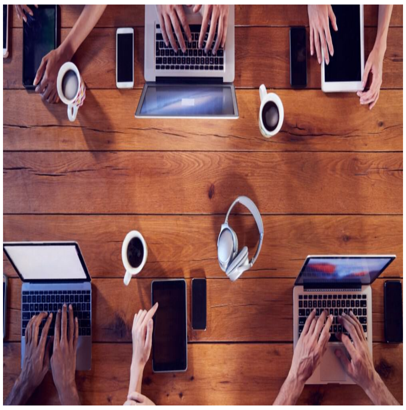

Alert: Tech Stocks Like Shopify (TSX:SHOP) Could Implode in 2021

Description

Shopify (TSX:SHOP)(NYSE:SHOP) has had an incredible run this year. However, Shopify stock has lost roughly 11% of its value over the past week since it reported earnings. In fact, it lost 7.8% on the day after the earnings alone.

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Although the drop is nothing compared to Shopify's astounding gains in 2020, it is noteworthy for technology investors. I believe the post-earnings drop is a worrying sign for the tech sector in 2021. Shopify stock, along with several other tech giants, could implode soon. Here's why.

Growth pulled forward

The ongoing pandemic has unleashed a wave of adoption in new industries. As people were confined to their homes, for the first time in a century and perhaps the first time in their lives, they had to adopt new habits. These new habits included online payments, online shopping, remote work software, streaming services, and food deliveries.

You'll notice that tech stocks across these industries saw record numbers of new users this year. Unsurprisingly, their stocks surged. However, this spurt of adoption cannot last forever. Eventually, everyone who was likely to adopt digital tools and services will have already done so. People who didn't adopt them in quarantine, may never get to it.

That means growth in 2021 and beyond will be a struggle for most tech stocks. The trouble is some, such as Shopify stock, have priced-in this above-average growth rate.

Shopify stock valuation

Last week, Shopify stock was trading at an unbelievable 660 times earnings per share. The stock was also trading at a price-to-sales (P/S) ratio of 67. For context, the **Nasdaq 100** trades at an average P/S ratio of 3.9. Historically, the Nasdaq 100 has traded at between one to 3.5.

Put simply, the entire tech sector is looking overvalued. Shopify stock could be one of the most overvalued of them all. To justify its current ratios, the company would have to *double* annual revenue every year for the next four years. As we’ve mentioned before, that seems unlikely.

In fact, year-on-year growth in this most recent quarter was also just below doubling at 96%. So, expecting sales to double in 2021 or every year would be too optimistic at this stage. If growth in the next few quarters falls below expectations (or 100%) the stock could correct sharply.

Other tech stocks

Other tech stocks are in a similar position. Investors cannot expect the current growth rate in payment processing, digital subscriptions, and streaming services to carry on forever. Growth rates could, in fact, dip significantly in 2021, as the economy and society lurches towards normalcy.

So, it may be a good time to reduce your exposure to the tech sector, take some profits, and wait on the sidelines.

Bottom line

Shopify stock is priced to perfection. It could fail to live up to investor expectations in 2021, which could cause a correction. This is true for most other tech stocks as well. Savvy investors should remain cautious.

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