Market Correction: Could We Kick off 2021 With a “Vicious” 10-15% Pullback?

Description

Stop me if you’ve heard this one before: the stock market looks pretty frothy going into the new year, and it’s coming in hot, perhaps too hot. Given the rally we’ve had since those depths of March, it definitely feels as though we’re overdue for another vicious market correction in excess of 10%.

Fasten your seatbelts: The risk of a market correction may be high

Still, there are no guarantees that the froth will be cut off this market anytime soon. Although the folks at CFRA did recently warn investors to brace themselves, as they thought the stock market was “vulnerable to a pullback” over the near-term. CFRA points out that recovery expectations are a tad on the high side, which could set the stage for a first-quarter pullback.

In a prior piece dated December 31, I also urged investors to not discount to odds of negative surprises in the first half of the new year, noting that 2021 recovery expectations seemed a bit too high, leaving little wiggle room for Mr. Market to react in response to any negative surprises.

“Could 2021 recovery expectations be a tad too high?” A question I raised in a prior piece titled ‘Could the COVID-19 pandemic crash the market again?’

“If there’s one thing we can takeaway from 2020, it’s that few things are more unpredictable than biology, whether it be talking about viral mutations and their implications on public health and the economy, or vaccine breakthroughs — scientific marvels that are comparable to that of the moon landing.”

How to invest in 2021? Be bullish, but pick your spots carefully

There’s no question that many folks are investing with the assumption that the handful of safe and effective vaccines will eventually conquer COVID-19 and that an abrupt recovery will follow. Some folks are willing to pay-up whatever price that Mr. Market's asking for at any given instance. If the central bank has our backs as investors, why wouldn't one look to hit the buy button furiously across the board? Especially with those "sexy" growth stocks that seem to be a ticket to quick and easy gains!

Valuation always matters as I've noted in many prior pieces, urging investors to tinker their models to the upside to account for the strange pandemic-plagued environment we find ourselves in.

Sure, if you stood by traditional valuation metrics, you probably bought nothing though most of the year. If you ignored valuation, you probably did ridiculously well as stocks continued on their V-shaped trajectory. With stocks continuing to swell into the new year, though, paying any price for stocks could turn out to be a dangerous proposition.

Sure, I still don't think the market isn't as expensive as it seems. But that doesn't mean you've got a free pass to play the game of greater fools with speculative assets like Bitcoin or frenzy stocks like **Telsa**. Instead, investors should consider valuing companies on a comparable basis and steer clear of pockets of severe overvaluation, some of which seem as obvious as the likes of a Tesla, or look to areas of the market that have been neglected.

The next market correction could be "vicious" and unforgiving

At this critical market crossroads, many may be discounting the "bumpiness" of the road to post-pandemic normalcy.

There's a considerable amount of margin debt built up in recent months, and if we are due for a pullback, one should not expect it to be anything short of vicious. Everything happens at warp speed in this kind of market, whether we're talking about rallies (November was the best month for stocks in decades) or market crashes (the February-March meltdown is in the record books as being one the steepest +30% plunges).

Mr. Market could get another shot in the arm once this horrific second wave (or third in some parts of the world) dies down. But dirt-cheap plays like **Fortis** sport a better risk/reward versus the likes of any other momentum play that could amplify downside in the next correction.

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