Is the Tech Stocks Bull Market Over?

Description

Tech stocks have been in a secular bull market for over a decade. If you bought any social media, e-commerce, enterprise software or electric vehicle stock over the past year, you're probably sitting on handsome profits. However, this week something changed. Major tech stocks are sliding lower. Could this be the end of the bull market?

Here's a closer look.

How do bull markets end?

The two key drivers of a bull market are also the catalysts for its demise. Sentiment and valuation are the basis of every bull or bear market.

Over the past year, tech companies have seen tremendous growth across the top and bottom lines. Online sales spiked while everyone was confined to their homes. People subscribed to streaming services for entertainment and companies bought software for working remotely.

This improvement in fundamentals caused tech stocks to surge. However, the surge went beyond the fundamentals recently. Investor sentiment was simply too ecstatic. Pre-revenue companies were trading at multiples of future estimated sales. Meanwhile, investors rushed into the heavyweight tech names without analyzing the fundamentals.

As tech stocks fall this week, it seems investors are recognizing the overvaluation. Concerns that tech companies may feel to meet expectations of growth in the near-future are also negatively affecting sentiment. That means the bull market could be ending soon.

Vulnerable tech stocks

Canadian tech stocks that have dominated the headlines and could be trading at unreasonable valuations may be the most vulnerable. **Shopify** (TSX:SHOP)(NYSE:SHOP) is a prime example.

Although I admire the company and am bullish on its long-term prospects, the near-term picture is a little grim. Shopify stock is down 13% from its all-time high last month. Despite that correction, the stock is still trading at a price-to-earnings ratio of 495. The price-to-sales ratio is a jaw-dropping 53.7.

Even if Shopify doubled sales every year for the foreseeable future, that valuation is preposterous, in my opinion. In fact, even Shopify's management warned that the growth rate could slow down.

Shopify President Harley Finkelstein said the crisis had created a permanent shift in shopper behaviour, but the company still expects growth to slow down in 2021. Inevitably, some online shopping will shift back to brick-and-mortar once the vaccination drive gains steam and the economy reopens.

Several other tech stocks could be similarly vulnerable. It may be a good time to look through your tech portfolio. If the stock is trading for an extremely high valuation and was positively impacted by the lockdowns, consider trimming the position.

Bottom line

Someone smarter than I am once said, "The cure for high prices is high prices." In the tech sector, prices have rarely been higher. From niche startups to well-established juggernauts, tech stocks are trading at historically high P/S and P/E ratios. Investors are extrapolating growth rates from the past year over the next few years.

However, the crisis is receding and the economy is reopening. Meanwhile, interest rates are starting to soar higher. This could be the end of the bull market in tech stocks. It's probably a good time to reassess your positions.

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