



## Part 2 – A Beginner's Guide to Researching a Stock

### Description

In my previous article, I talked about how to research a stock using a bottom-up approach. This strategy works well if you already have a stock in mind. You are only confused about when to invest, how much to invest, and when to book profit. But if you don't have a stock in mind but just a sector, you might want to use a top-down approach.

Think of this as choosing a movie from **Netflix**. Your friend recommended you a movie, so you watch the trailer, read the synopsis, and then decide to watch. That is the bottom-up approach. But there are times when you are just browsing through the library and choose a movie by genres like action, comedy, or horror. That is the top-down approach.

### Researching a stock using a top-down approach

When researching a stock using the top-down approach, you first have to select the sector, trend, or theme and then look for shares. If you are new to investing, I would suggest you stick to the large-cap stocks or market leaders in that particular industry. For instance, you want to build an e-commerce portfolio or a tech stock portfolio. You need to ensure that you have a mix of growth, dividend, resilient, and maybe speculative stocks. Such a portfolio will help you mitigate risk.

Now that you know the prerequisites, let's begin the research.

### Step 1 – Understand the sector's growth and risks

First, select the sector you want to invest in and understand the risk and opportunity. Within the sector, you can diversify across different trends and themes. For instance, if you choose energy, you can have a mix of both renewable (solar, wind) and non-renewable energy (oil and natural gas).

Here I will take the tech sector, and in that, I will choose e-commerce. E-commerce found its glory during the pandemic, and many research firms upped their industry growth forecast. Meticulous Research [expects](#) the global e-commerce market to increase at a CAGR of 22.9% from 2020 to 2027. You will find such industry reports on the internet. They will also state the growth drivers and roadblocks.

## Step 2 – Follow up on the news around the industry

Now you know the factors that affect the industry and trends around it. This will help you understand which news is good or bad and how it will impact the industry. For instance, [the crypto](#) trend is volatile, and it has been gathering headlines for its 800% rally. But what causes these ups and downs.

You can look at The Motley Fool Canada articles around why a stock rose or fell. Sometimes it is company-specific, and sometimes it is because of macro factors like a government action. For instance, most [stocks fell](#) in September 2020 as people were unsure whether they would get their stimulus money. Hence, they booked profits. So even when the e-commerce sector was doing well, **Lightspeed POS** ([TSX:LSPD](#))([NYSE:LSPD](#)) and **Shopify** ([TSX:SHOP](#))([NYSE:SHOP](#)) stocks dipped 12-15%. If you did your research and knew the news wouldn't impact their growth factors, you would have bought the dip as it was temporary.

## Step 3 – Identify market leaders

Once you understand the industry, you should consider investing in stocks riding the sector growth. A good strategy would be to compare the company's revenue growth with the market compound annual growth rate (CAGR). Shopify's and Lightspeed's 2020 revenues grew 85%. This shows that these companies are at the peak of industry growth. This rate could normalize to around 23% (industry CAGR) in the long term.

If you bought these stocks early in the pandemic, hold them. They may not surge three-fold as they did in 2020, but they have the potential to grow by double-digits in the long term.

## Step 4 – Read the company's financial reports

And finally, read a company's financial statement to keep a tab on its performance. All this might look intimidating, but the efforts will pay off.

May the research be with you!

### CATEGORY

1. Investing
2. Personal Finance
3. Tech Stocks

### TICKERS GLOBAL

1. NYSE:LSPD (Lightspeed Commerce)
2. NYSE:SHOP (Shopify Inc.)
3. TSX:LSPD (Lightspeed Commerce)
4. TSX:SHOP (Shopify Inc.)

## **PARTNER-FEEDS**

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