3 Signs the Stock Market Could Be About to Pull Back

Description

Stocks have been going up and to the right for well over a year. After last year's brief dip, the **TSX 60 Index** has delivered a jaw-dropping 70.5% return. For context, the index's average annual return was roughly 7% for the previous decade. That's made some investors worry about an imminent stock market crash.

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A stock market pullback is never easy to predict, but investors can keep their key on certain signals that have preceded recessions and crashes in the past. Here are the top three signals emerging now.

GDP

Gross domestic product (GDP), the flagship measure of our national output, is a key signal. A growing economy can overcome several hurdles such as inflation and debt. However, a dip in GDP growth should be concerning for investors. This concern is amplified when the dip is *unexpected by experts.*

That's what seems to have happened over the past month. Canada's GDP dipped 0.3% in the three months between April and June. Economists and investors were expecting *growth*, as the lockdowns were eased and pent-up demand was unleashed this summer. It turns out that Canada's GDP is now still 1.5% smaller than before the crisis erupted in early 2020.

This is a bad omen for the stock market. If the downturn continues, investors may have to adjust their stock valuations.

Valuations

Stock valuations paint a very different picture. At the time of writing, the stock market's total value is 173.5% of national GDP. This is known as the Buffett Indicator, and a ratio above 100% is considered significantly overvalued.

The stock market's price-to-earnings (P/E) ratio is 38 at the moment, which is already historically high. That ratio could have been justified if corporate earnings were growing, but it seems like they're not.

Missed expectations

Some major corporations have missed earnings expectations this quarter. **CIBC** missed analyst estimates because of a downturn in mortgage and interest income. Meanwhile, luxury retailer **Canada Goose** also missed expectations and lowered its sales outlook for the rest of the year.

Protect yourself

Despite the signals mentioned above, there's no way to predict a stock market crash. The current bull market looks overdone, but it could ride on for months or even years more.

Nevertheless, allocating a part of your portfolio to a robust, recession-resistant stock is always a good idea. Some stocks, like **Fortis** (TSX:FTS)(NYSE:FTS), suffer minimal damage when the stock market dips. For instance, Fortis stock lost just 5% of its value in March 2020 to April 2020, during the previous crash.

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Now trading at a P/E ratio of 22, the stock still looks attractive. Not to mention the fact that Fortis is on track for 50 consecutive annual dividend increases, which would make it a Dividend King. If you're uneasy about the stock market, this is an ideal shelter.

Bottom line

Canada's GDP is slowing, while corporations cut their outlook and valuations remain sky-high. A potential stock market pullback or crash cannot be ruled out, which is why investors should protect themselves with robust stocks like Fortis.

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