3 Canadian Stocks That Are Value Traps

Description

Value investors love a good bargain. Seeing cheap stocks as undervalued opportunities, they like to buy them up before they recover. And until recently, they were right. For most of the 20th century, value investing outperformed other strategies, according to numerous studies. Notably, the most famous investor of all time, Warren Buffett, employed the strategy. As did many other market-beating money managers like Li Lu and Ben Graham.

But recently, value investing has lost its lustre. With the rise of FAAMG and innovator stocks, value stocks have fallen out of favour. This condition may not be permanent, but it has been the case for at least a decade. With that in mind, here are three "value trap" stocks that I personally would avoid.

Air Canada

Air Canada (TSX:AC) is a value stock by at least one metric. It has a price-to-sales ratio of just 2.34, which is pretty low for stocks these days. Traditionally value investors looked for price-to-sales ratios of two or less, but they're hard to come by in today's market. By 2021 standards, AC's price-to-sales ratio is low.

With that said, most of the stock's other value metrics are poor. Its price to book ratio of 14 is quite high, it has negative earnings, and it faces a number of risk factors, including:

- The Delta Variant of COVID-19
- Rising debt
- Bad publicity
- And more.

Based on the price/sales ratio, Air Canada looks like it could be a good value–particularly if sales increase and earnings turn positive. Unfortunately, there are too many risk factors at play now to just assume that Air Canada will turn out positive earnings in the near future.

Baytex Energy

Baytex Energy (TSX:BTE)(NYSE:BTE) is another **TSX** stock with some good value metrics. These metrics include:

- A 1.93 price to sales ratio.
- A 1.32 price to book ratio.
- A 1.74 P/E ratio.

The P/E ratio being lower than the price/sales ratio appears to be due to hedging strategies the company uses, which can result in unrealized gains. With that said, the price/operating cash flow ratio (about five) is extremely low as well.

This stock certainly looks like a rock-bottom value. The problem is that it is very dependent on high oil and gas prices. The stock was tumbling into the abyss from 2014 until earlier this year, as the price of oil was weak then. More recently the stock has been rallying on higher oil prices. This has worked out well so far, but if the price of oil starts collapsing again, BTE is going down with it.

Canadian Imperial Bank of Commerce

The **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is a Canadian bank stock with very attractive value metrics. Trading at 10.5 times earnings, 3.5 times sales, and 1.6 times book value, it definitely looks cheap. The stock also has respectable earnings growth of 7.8% annualized over the last five years.

This stock is not a value trap in the sense of being an actively bad investment. I actually expect this stock to rise modestly over the long term. The “trap” in this case is the fact that the stock is limited compared to other alternatives. While CM trades at similar multiples to other Canadian banks, it has much less growth potential because its operations are so concentrated in Canada.

Whereas other Canadian banks are growing in the U.S. and other foreign markets, CM mostly sticks to its home turf. So it has less growth potential due to its geographic limitation.

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2. Investing

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2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:BTE (Baytex Energy Corp.)
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