Are Stocks Too Expensive? 2 Reasons Why They Aren't

Description

The **S&P/TSX Composite Index** has been on another volatile run in recent weeks. After hitting new all-time highs in November 2021, the Canadian benchmark index is down by 4.73% at writing. Considering that the stock market has been on a constant upward trend throughout this year, it's leading many investors to think that stocks are too expensive.

Barring the COVID-19-frenzy-fueled downturn in February and March 2020, the stock market has been rising for over a decade. The Canadian benchmark index is up by a massive 54.04% since mid January 2011, a return much more significant than the decades before this. It is natural to assume that the stock market is overheating right now.

A short-term pullback had been long overdue, and we might be in the middle of that right now. However, stocks, as a whole, might not be overvalued. It is true that prices for equity securities like the top tech stocks are rising, but so are earnings. If you consider a stock's valuation expensive or cheap based on its earnings, most stocks might have become cheaper.

The Price-to-Earnings ratio is slowing down

Taking a look at the **S&P 500**'s average performance can put things into better perspective. The index was trading at a historically high 35 price-to-earnings (P/E) ratio for most of 2021. The S&P 500's P/E ratio had not been this high since 2009, during the peak of the last great recession. Stock markets worldwide saw massive declines, but the overall economic environment also meant lower earnings for companies.

The overall historical average P/E for the market is 18. The ratio hitting 35 would be a major cause for concern. However, the P/E ratio has been going down. At writing, the P/E for the S&P 500 sits at 29.41. Many companies saw challenges riddle their paths during 2020 but have spent most of 2021 recovering from the impact of COVID-19.

This year has painted a completely different picture for most TSX stocks. The changing economic landscape in the new normal has led to several companies seeing revenues soar this year. The tech sector has done particularly well due to technology playing a crucial role in facilitating the new normal.

Tech stocks are no longer as expensive as they initially were

The tech industry and some of the top tech stocks like **Shopify** (TSX:SHOP)(NYSE:SHOP) and **Lightspeed Commerce** (TSX:LSPD)(NYSE:LSPD) are primary reasons stocks became so expensive. Lightspeed Commerce had been unbelievably expensive the last few years. Then, the stock kicked things up a notch as the pandemic hit, reaching a P/E ratio of 50 at one point.

At writing, the situation has changed entirely. Lightspeed Commerce stock is trading for $50.90 per share, down by almost 70% from its all-time highs. At current levels, Lightspeed Commerce stock boasts a price-to-sales ratio of just 14.30. If there was ever a cheap stock to consider buying on the dip, it would be Lightspeed stock today.

It might take some time for the stock to regain momentum, but it will likely recover to its all-time high and surpass it in the coming years.

Foolish takeaway

The ongoing market correction is creating plenty of opportunities for investors seeking value stocks right now. There are plenty of names that could be value traps after the correction. However, several TSX stocks could be temporarily cheap. If you are looking for such investments, Lightspeed Commerce stock could be one of them.

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