2 High-Quality Software Stocks That Have Become Too Cheap

Description

Software stocks have taken endless hits to the chin amid the recent rate-induced round of selling. Indeed, there may be nothing to fear other than fear itself, as investors brace for a rapid pace of rate hikes courtesy of the U.S. Federal Reserve, which hasn't sounded this hawkish since the back half of 2018, a time when the "Fed put" kicked in.

We all know that rates are headed much higher from here. With 3% within the realm of possibility to get rid of the hot inflation levels, investors have sold risk-on, unprofitable growth stocks ahead of time. Still, the calm before the storm may be the worst part of the whole rate-hiking cycle, as the legs of the economy are put to the test. I think the economy's legs are strong enough to stomach as many as nine rate hikes. Of course, geopolitical turmoil is not doing the Fed any favours, as it strives to soften the blow of its tightening cycle.

Software stocks with staying power

Surprisingly, Canadian software stocks like **Constellation Software** ([TSX:CSU](#)) have held quite steady versus the broader basket of high-tech growth. Despite the alarmingly high multiple (shares of CSU currently trade at a jarring 115 times trailing earnings), shares have only sagged by around 15% before posting a partial bounce-back around $2,100 per share.

What makes Constellation more resilient than the rest? It has a rock-solid balance sheet and a proven, predictable profitability plan. The company has made brilliant acquisitions in the smaller end of the tech scene over the years. And it continues to grow its book, even as a $45 billion behemoth.

Further, Constellation doesn't blow big money on those exciting unicorns with slim chances of breaking into a profit. The company focuses on smaller software firms with real fundamentals that it can help make better. Indeed, discovering hidden gems on the TSX Index is what Constellation does best.

Over the years, it's been a steady upward ride for CSU stock, blasting off around 240% over the past five years. Indeed, the stock has seen its fair share of market [corrections](#), but with a lower correlation to the TSX, it's marched higher every time. After not doing much over the past nine months, I think the

recent slip in the stock is yet another buying opportunity. Though the multiple is extended, I think the firm is more than worth the premium price tag, even as rates climb even higher.

Descartes Group stock looks enticing as shares flop

Descartes Group (TSX:DSG)(NASDAQ:DSGX) is another Canadian exclusive that seems to have held its own rather well versus the many Nasdaq 100 names that have shed more than half of their value in recent quarters. The stock is down around 27% from its high because of its lofty multiple, which has become somewhat less lofty in recent weeks. At $82 and change per share, DSG stock sports a 65 times trailing earnings multiple. That's expensive for the supply-chain solutions software developer.

With a 14 times price-to-sales multiple, DSG may have deserved to have fallen alongside other tech names. Still, with global supply chains and logistical networks still in chaos at the hands of COVID, I'd argue that many of the tailwinds enjoyed in 2020 are still in play. For that reason, I think DSG stock shouldn't have taken such a hard hit to the chin. In any case, expect DSG to fall as rates rise above 3%. If inflation peaks and rates pull back, though, expect DSG stock to make up for lost time.

CATEGORY

1. Investing
2. Tech Stocks

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1. Editor's Choice

TICKERS GLOBAL

1. NASDAQ:DSGX (Descartes Systems Group)
2. TSX:CSU (Constellation Software Inc.)
3. TSX:DSG (The Descartes Systems Group Inc)

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