



1 Surprisingly Undervalued TSX Stock to Buy in May 2022

Description

The post-pandemic world is very different from the pandemic and pre-pandemic world. Generous stimulus packages and record-low interest rates made [growth stocks](#) and tech stocks expensive during the pandemic. However, the fiscal stimulus also accelerated the economic rebound. The post-pandemic world is seeing high inflation and rising interest rates. This has [turned the needle](#) away from growth stocks to conventional assets and [value stocks](#), making them overvalued.

When value stocks become overvalued

High inflation

High inflation has made cyclical stocks like energy and real estate expensive. Oil prices are at their 2014 high, but the pent-up travel demand is not the primary factor driving oil prices. The Russia-Ukraine war and sanctions on Russian oil have tightened an already tight oil supply. Economists and oil companies expect oil prices to hover around US\$100/barrel throughout the year.

Suncor Energy is trading at 14.8 times its earnings per share (EPS). **Canadian Natural Resources** even touched a [\\$1 billion market cap](#). **Choice Properties REIT** is trading near its all-time high at 220 times its EPS. All these stocks were value stocks before and during the pandemic. Some oil and real estate stocks even slashed dividends and hit multi-year lows. But they have now become overvalued, as high inflation helps them charge a higher price for their products.

Interest rate hikes

The fear of interest rate hikes created a [selloff](#) in growth stocks as the risk premium increased. Let's understand risk premium. Government bonds are the safest investment. The interest rate they offer is called the risk-free rate. When valuing growth stocks, future cash flow from growth stocks is discounted with a risk-free rate. This discounting cash flow tells you how much risk premium the growth stock can give you over the risk-free rate. In simple words, it tells you how much extra you can get if you put your money in growth stocks instead of government bonds.

When interest rates fall, investors don't get an incentive for investing in government bonds. Hence, they move to riskier growth stocks to earn the premium for taking the risk. When interest rates rise, the safer government bonds become attractive again, and investors move back to investing in bonds. Growth stocks have to offer a higher risk premium to attract these investors.

One undervalued stock to buy in May 2022

The new business environment of rising inflation and interest rate have made value stocks overvalued and growth stocks undervalued.

"The time to get interested is when no one else is. You can't buy what is popular and do well."

Warren Buffett

At present, energy and real estate stocks are popular. Hence, they are trading at their 52-week highs. But areas no one is interested in is automotive and technology. That is where the real value lies.

Magna International ([TSX:MG](#))([NYSE:MGA](#)) is one such stock that has strong fundamentals, but the current market environment has undervalued its growth potential.

The electric vehicle (EV) trend is here to stay, as major economies aim to achieve net-zero emissions by 2050. Automakers and tech giants worldwide are investing billions of dollars in making new EVs, and Magna is a supplier to 24 of the 25 top EV makers.

However, the EV trend is grappling with supply chain issues, as the Russia-Ukraine war shot up commodity prices and prolonged semiconductor shortages. Moreover, fresh COVID lockdowns in China, the world's largest automotive market, could slow growth in EV sales.

These short-term difficulties have pulled Magna stock down 25% year to date. It is trading at 0.5 times its sales per share and 10.6 times its forward EPS. The company has a huge pent-up demand, which it can fulfill once supply eases. The stock could cross the \$100 mark, representing a 40% upside. In the meantime, you can lock in an approximate 3% dividend yield.

Foolish takeaway

Buffett said, "If a business does well, the stock eventually follows." Magna has a strong business, and its stock price is a bargain you don't want to miss. The stock price will eventually follow the business fundamentals and help you reap the benefits of value investing.

A couple more undervalued stocks are **Descartes Systems** and [Shopify](#).

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