Buy the Dip: Growth Stocks Are Finally Cheap!

Description

Growth stocks have been shedding value for months. There are concerns that there could be more pain ahead. But the recent declines have finally made some stock valuations attractive. Here's why stocks are finally cheap and what investors should consider buying.

What is a "cheap" stock?

Some investors consider the price tag of a stock a measure of its cheapness. However, a better way to describe a cheap stock is one that's trading below its real value.

For instance, a stock that delivers $6 in dividends and trades at $100 could be cheaper than a stock that trades at $10 and offers no dividends or earnings. By this measure, any stock trading at low valuation multiples (such as price-to-earnings multiple) could be considered cheap.

Are stocks cheap?

The aggregate P/E ratio of the largest companies on the Toronto Stock Exchange is 19.6. That's lower than last year's ratio of 24.2. It's also the lowest ratio since 2020. Adjusted for the earnings of the next 12 months, the ratio drops to 13.9 — the lowest level since 2018.

Put simply, the overall stock market is cheap. That's not surprising since the Canadian market is dominated by energy and bank stocks, both sectors that could see higher earnings in the months ahead. But valuations have adjusted because tech stocks are no longer *overvalued.*

Which stocks to buy?

Since the overall market is cheap, there are plenty of buying opportunities. Investors have a chance to deploy cash at reasonable valuations. However, the *right* stock depends on your investment objectives.

If you're looking for safe passive income, a blue-chip energy stock like **Enbridge** could be the right candidate. However, growth investors should probably focus on the technology sector. Stocks like **Constellation Software** (TSX:CSU) are severely beaten down.

Constellation is arguably Canada's best enterprise software conglomerate. The company's underlying subsidiaries offer niche accounting, data management and inventory tracking software. These boring businesses are much more resilient to the market cycle. In fact, roughly half of Constellation's clients are government agencies, which adds another layer of protection.

Constellation stock is down 18% year to date. Meanwhile, the company has ramped up acquisitions which should propel growth higher. Based on my calculations, the stock is trading at a forward price-to-free cash flow ratio of 24. That's cheap for a high-growth tech stock.

Investors seeking a relatively safe opportunity in the tech sector should certainly add Constellation Software to their list.

Bottom line

Investors are worried about inflation and rising interest rates. While these concerns are justified, the stock market has dropped too far. Valuation ratios are now lower than they've been in years. Conservative investors can bet on oil and bank stocks that still look attractive. But if you're seeking a bargain and have some appetite for risk, consider tech stocks like Constellation Software.

Buying cheap stocks when the market is beaten down is an excellent way to boost long-term performance.

CATEGORY

1. Investing

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3. TSX:ENB (Enbridge Inc.)

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