TSX Tech Stocks: The Bottom Could Still Be Far

Description

There has been no respite for growth investors. Expectations of stocks bottoming out is bringing more downside every time. TSX tech stocks are down about 40%, implying a major weakness this year after having a blast in the last two years.

Canadian tech titan **Shopify** has fallen 80% in the last six-odd months. Nobody ever imagined such a brutal correction in Canada's once top value creator during its golden period amid the pandemic. Investor favourite **BlackBerry** has dropped 42% this year. As rates have risen, many tech names have shown a similar weakness amid valuation concerns.

8.6%!

A May 2022 inflation reading of 8.6% implies that things will not be easy in the short term. Moreover, it underlines the fact that while experts have echoed that inflation has peaked, it is not really the case. A rapidly increasing inflation suggests that Fed's interest rate hikes implemented so far have been little useful. So, they might have to device faster, bigger hikes going forward.

Market participants are expecting a 0.5% interest rate rise this week from the U.S. Fed. However, what will be really crucial to watch is whether it delivers more than that and how hawkish the stance will its stance be going forward.

The Russia-Ukraine war has aggravated the situation this year with record oil and gas prices and supply chain bottlenecks. Rapidly rising inflation directly hampers real wages and salaries and dents consumers' discretionary spending.

Why stocks fall when rates rise

When rates are raised, the discount rate to value an asset rises, eventually making the present value of their future cash flows lower. As a result, the stock's fundamental value deteriorations in the rising-rate environment, and we see lower price targets emerge from analysts. That's why stocks have notably dropped in 2022.

In addition, Treasuries have become more attractive assets amid the rising rate situation. So, investors take shelter in these safe havens by dumping risky assets like stocks.

So, should you invest in TSX tech stocks now?

Well, hold your horses!

It totally depends upon your risk profile. Yes, a few names have fallen by 60-70% in the last six months. But that should not be the sole criteria to jump on board.

If you are comfortable with a 20-30% drawdown from here, it makes sense to enter. However, note that, in some cases, we have seen an outsized impact, and there could be a faster recovery than others, probably in the medium term. So, there is also a timing factor involved if you decide to wait.

Another aspect to consider is the company's growth record before the pandemic. For example, Shopify's business flourished in all directions during the pandemic. But it has a proven track record before the pandemic as well. So, it is nothing like how video conferencing stocks zoomed during the pandemic and went down later.

In the case of BlackBerry, the company is struggling on almost all fronts. Its declining revenues and intermittent profits make its stock more susceptible to the rising rates. So, BB stock might continue to see weakness.

Bottom line

There's no way to tell when will stocks bottom out. After last week's runaway inflation reading, there is a high probability that the policymakers and analysts will reorganize their models to fit the more hawkish stance. So, TSX tech names might see more weakness going forward. If you are sitting on cash, it makes sense to deploy some now and allocate some of it to buy at lower levels.

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Author
vinitkularni20