Top Pick for August 2022: A Battered Growth Stock to Buy as Inflation Peaks

Description

Growth stocks led the Wednesday rally, as the Federal Reserve soothed investors, downplaying concerns that we're already in a recession while keeping the door open for a jumbo rate hike at some point down the road. Indeed, the Fed is staying with the game plan, but it's keeping an ear to the data. For investors, this is a best-case outcome: a central bank focused on driving down inflation while looking to minimize damage to financial markets.

With such transparency, the Fed may have allowed the market to continue adding to its recent rally. Earnings have been a mixed bag in Q2 thus far. Regardless, the bar has been set lower. Modest results and even mild earnings misses can be enough to move the needle higher on stocks. That's just how oversold the stock market was.

Indeed, many investors are likely feeling more comfortable about putting a bit more cash to work in stocks. Sure, the economy could continue slowing down, and a recession could strike as soon as Q1 2023. However, as the Fed pointed out, many job vacancies remain. This does not suggest that we are currently in a recession, though things could change fast, as tech companies continue announcing job cuts and hiring freezes.

Fed calms investors, gives hope to the ailing growth trade

Aside from the state of the tech sector, it doesn't seem like a recession is inevitable. If anything, a recession may be avoided, as growing evidence of peak inflation comes rolling in. Oil has fallen over US$25 from its peak. Agricultural commodities have also taken a bit of a tumble. With **Walmart** at risk of an inventory glut going into year's end, we may very well see markdowns and disinflationary pressure that could drag inflation down without having the Fed deliver any more supersized rate hikes.

Canada's 8.1% inflation rate is alarming. But it may be close to the worst that it will get, as the economy cools off, and disinflationary factors have a chance to work their magic.

As inflation looks to peak, there will be less need for those 75-100-bps rate hikes. As a result, rates on the 10-year note yield could retreat further below 3%, and it's the high-growth trade that could heat up again.

Growth stocks getting oversold by jittery investors

Growth is so heavily oversold that it's getting ridiculous. Any rate relief is sure to give fallen stars like **Shopify** (TSX:SHOP)(NYSE:SHOP) a massive upside jolt.

Shopify stock has been wildly volatile this week. Yesterday, the stock plunged by more than 14% over news that the firm is cutting 10% of its workforce (about 1,000 employees). Today, the stock is up 11%. Double-digit percentage moves in Shopify have become the norm. Fortunately for investors, I believe that the beaten-down e-commerce darling could be in for a rapid move towards $100 per share if rate concerns die down.

Further, a lot of negativity is already baked in: profound retail headwinds, layoffs, and an acknowledgment from the CEO that it made a mistake by over hiring. Indeed, it seems like nothing can go right for the stock. However, I remain bullish, because there's just too much bearishness out there. Though it's hard to tell when retail sales will come roaring back, I am a fan of SHOP stock's risk/reward scenario from a long-term perspective.

Shopify stock could soar back once the new bull market is ready to roar

The recession will pass, and retail sales will make Shopify a must-own again. At writing, Shopify stock trades at 8.2 times price-to-sales (P/S). That's still above the industry average of six times.

However, given Shopify's massive total addressable market and the likelihood that many high double-digit percentage (think 30-40%) revenue-growth days lie on the other side of the coming recession, I believe Shopify stock deserves to trade at a much larger premium to the peer group.

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