TSX From Windfall to Free Fall: Where is the Value?

Description

The last three years have been a rollercoaster ride for global stock markets, including the **Toronto Stock Exchange** (TSE). After the windfall gain in 2020 and 2021 led by the stimulus money, the TSX is in a free fall as the government pulls back the stimulus checks. For those who understand the mechanics of the market, every cycle has winners and losers. While the buy-and-hold strategy works for the long term, a little active investing brought value investors windfall gains. Where is the next value after tech and energy?

TSX 2020 value-driven gains

In 2020, the pandemic shifted the focus to tech stocks. Everyone was upgrading their laptops and mobile phones, e-commerce was at its peak, and more companies adopted a remote working culture. If you understand the behaviour of the stock market, most retail investors buy stocks of companies that are trending and visible.

Tech companies raised too much equity capital on investor optimism, creating a bubble. This money flowing into the stocks came from the generous stimulus checks.

At this time, value investor Warren Buffett invested in oil stock **Suncor Energy** and oil and gas pipeline company **Dominion Energy**. They were trading at a record low during the pandemic as lockdown pulled oil prices below US$35 and created an oversupply in the market. This bet paid off in 2021. Also, those who jumped into the tech stock rally early in 2020 made windfall gains in 2021.

TSX 2021 windfall gains

But as they say, there are no free lunches. Many hedge fund investors knew there would be a payback time. The stimulus money is the taxpayer's money. When the government is out of funds, it will pull back and correct the inflated prices. Thus, hedge funds were the first to sell off their tech stocks worth millions of dollars, even at a discount, on the early signs of an interest rate hike in December 2021.

The year 2021 was strong for oil stocks, which benefitted from a recovery in demand as pandemic restrictions started to ease. However, the growth wasn't full-fledged till pandemic restrictions were lifted completely by the end of the year.

Investors who despised oil stocks befriended them and started mistaking them for growth stocks. A rally ensured in oil stocks as oil prices jumped from US$40 to over US$80 by the end of 2021. But this value is fading in 2022.

TSX 2022 free fall

The market is heading towards a recession. Energy stocks reached their cyclical peaks in June and are now heading into a steep correction. The Fed interest rate hikes are putting downward pressure on oil demand. Meanwhile, energy stocks are experiencing volatility as the Organization of the Petroleum Exporting Countries (OPEC) tries to maintain a higher oil price by cutting supply.

However, the tug of war between interest rate hikes and supply cuts could keep oil prices under pressure. Moreover, any major developments in the Russia-Ukraine war could change the oil and gas story.

In times like these, you could buy companies in the oil and gas supply chain, like energy infrastructure company **Enbridge** that has indirect exposure to energy prices.

As for interest rate hikes, mortgage costs are increasing, discouraging potential homebuyers from purchasing a home. Canada has also started seeing the effects of a slowdown in employment and retail sales. Analysts expect the stock market to make a new low in the current correction.

The hunt for the next value stock

You can leverage this dip by investing in dividend and growth stocks with strong fundamentals and long-term demand for their products and services. The next value stock could be automotive components supplier **Magna International** (TSX:MG)(NYSE:MGA), which is waiting for the return of the electric vehicle (EV) revolution to make windfall gains. It has a $2 billion cash reserve to survive a recession. The chip supply shortage, rising inflation, and falling automotive demand due to the looming recession pulled the stock down 37% year to date to a 7.25x forward price-to-earnings (P/E) ratio. This value is high if you look at the next 12 months, but low from a long-term perspective.

Magna could grow its earnings by double-digits when the economy rebounds and supply issues ease. The stock could make a new high above $110 and also grow its dividends as it meets the pent-up demand for EVs.

Another value story could be renewable energy, as the shift to green energy is imminent.

CATEGORY

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2. NYSE:ENB (Enbridge Inc.)
3. NYSE:MGA (Magna International Inc.)
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