Why Shopify (TSX:SHOP) Stock Fell 5% in September

Description

Shopify (TSX:SHOP) took a beating in September. Falling 5% for the month, it went down more than the TSX Composite Index in the same period. It performed better than average by the standards of tech stocks: the NASDAQ-100 index (the index of U.S. big tech stocks) fell 6.99% in the same period. Depending on which benchmark you use (Canadian stocks or tech stocks), September could be thought of as a period of relative strength or relative weakness for SHOP.

In this article, I'll explore some reasons why Shopify fell 5% in September.

Broader weakness in tech

The main reason for Shopify falling 5% in September appears to have been broader weakness in the technology sector. Stocks are positively correlated with (i.e., move in the same direction as) other stocks. The positive correlation is particularly strong with stocks in the same sector.

September was a very weak month for tech stocks worldwide. The U.S. tech stocks listed on the NASDAQ fell 6.99% on average. Chinese, Korean, and Canadian tech stocks fell as well. Many portfolio managers make their buys through sector index ETFs; when they do this, they simply buy and sell all the stocks in the same sector at the same time. There was no news about Shopify in September, and its stock fell to a similar degree as other tech stocks in the same period, so it looks like sector-based trading is responsible for its price moves.

Interest rates rising

It's pretty clear that sector momentum explains at least part of Shopify's results last month. The question is why the tech sector performed so poorly. Tech companies are among the most innovative enterprises in the world, exactly the kinds of businesses you'd expect to appreciate in value. So, why'd they do poorly in September — and for most of the rest of this year, too?

Well, the thing is, no matter how innovative a company is, it doesn't deserve an infinite price.

Sometimes great companies get sold off when their stock prices go too high. Shopify is a notoriously expensive stock. At the height of the 2021 bubble, it traded at 60 times its annual sales! That valuation held up for a surprisingly long time. But then, something happened.

Central banks started raising interest rates. When central banks raise interest rates, expensive stocks tend to fall in price, because their future growth becomes less valuable. Why gamble on “possible future” returns, when you can get a decent yield on treasuries risk free? In general, higher interest rates make risk taking less rational. So, tech stocks tend to sell off when rates rise.

Company-specific factors

As I’ve shown in this article, Shopify’s September slide was probably mostly due to sector momentum and interest rates. However, there are some company specific factors that influenced its trajectory for the whole year. The big one would be the massive slowdown in its growth. In its most recent quarter, Shopify grew its revenue at only 16%; in 2020, it was growing at 90%. That kind of slowdown in growth demands a change in valuation, and that’s what happened with Shopify this year.

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