Buyer Beware: Why Cheap Stocks Aren't Always Bargains Worth Buying

Description

Looking for bargains in the stock market? Here's why you should give it a second thought. Stocks are often cheap for a reason. In market corrections, such as the one we're experiencing now, bargains are more abundant. Often, the stocks that have fallen less versus others in the same industry are the higher-quality ones.

Nutrien stock

Nutrien (TSX:NTR) stock has been a stronger performer than the market lately. Year to date, it's actually up 4% versus the Canadian stock market's decline of 8%.

That said, it could be difficult for retail investors to invest in basic material stocks like Nutrien unless they're familiar with the underlying industry. Specifically, for Nutrien, investors should have a thorough understanding of the supply and demand dynamics of potash, nitrogen, and phosphate. This knowledge will help them better predict whether the commodity prices will go up or down.

This basic material stock matches the classic definition of a cheap stock, trading at about 5.7 times earnings, as the underlying commodity prices have jumped and so has its profits. Currently, analysts believe the stock can appreciate about 45% over the next 12 months. However, its multiple can expand substantially should the underlying commodity prices retreat, which can occur without warning.

So, unless you know where the underlying commodity prices are going, it may be better to stay out of the name.

Chartwell Retirement Residences

An investment in **Chartwell Retirement Residences** (TSX:CSH.UN) stock allows investors to gain exposure to the trend of a growing aging population. These senior Canadians require more senior housing options. However, Chartwell's occupancy was negatively impacted due to the pandemic, which continues to weigh on its results. Its recent same-property occupancy rate for its retirement portfolio remains at about 77%. There’s a wide gap between this occupancy and its 2025 target of 95%.

Higher labour costs and rising interest rates are also increasing its operating and financing costs. Because of the lower occupancy and higher costs, Chartwell stock has been under immense pressure and declined 36% in the last 12 months.

Some analysts recommended the dividend stock on its way down. Now that the REIT yields 7.7% and trades at about 8.7 times its normal funds from operations, it may finally be time to buy the stock under $8 per unit for a multi-year turnaround.

At this point, interested investors might as well wait for its third-quarter results and corresponding conference call, which will be released on November 9 and 10, respectively, for the latest updates on the company before potentially buying shares.

The Foolish investor takeaway

Investors shouldn’t automatically buy depressed stocks because they typically sell off for a reason. Each stock investment requires careful due diligence. Even when you find quality stocks that are truly attractive, the macro environment can continue to weigh on the stocks.

Next time you find a value stock, also research its peers to see which holds up better in the long run for a potentially higher-quality buy. You can also reduce your portfolio risk by aiming to buy assets that have low correlation among them.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CSH.UN (Chartwell Retirement Residences)
2. TSX:NTR (Nutrien)

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