This Tech Stock, Down 70%, Could Rip if Interest Rates Change

Description

This year, a lot of tech stocks are declining in value. The NASDAQ — the U.S. index that most big tech companies are part of — is down nearly 30%. Canadian tech stocks are in much the same boat. Although the Toronto Stock Exchange has been helped this year by its many profitable energy companies, Canadian *tech* is not doing so hot. Some of Canada's biggest tech companies are down even more than the NASDAQ is, and it's no secret what's behind it: rising interest rates.

Both the Federal Reserve and the Bank of Canada are raising interest rates this year, and the higher rates go, the less valuable growth stocks become. Many tech stocks are growth stocks, so the current economic conditions are against them. That could signal more pain to come, but there's one TSX tech stock that could really start moving if rates come down.

Shopify

Shopify (TSX:SHOP) is a Canadian tech company that develops e-commerce software. "E-commerce" refers to buying and selling things on the internet; SHOP runs a platform that helps people do this.

For years, Shopify was one of the best-performing stocks on the TSX. From its initial public offering date to its all-time high, it rose 5,900%! Unfortunately, the all-time high was not to last. At the beginning of the year, central banks around the world started raising interest rates. When interest rates rise, future growth becomes less valuable, because the amount of return available "risk free" goes higher. As a result, stocks that take a long time to recoup investors' money tend to fall when interest rates rise.

This is exactly the situation that Shopify was in at the start of the year. To make matters worse, it even lost much of its growth in the first quarters of the year! In its most recent quarter, Shopify's revenue only grew 22%, and its earnings declined. Investors took note of this and sold the stock.

How SHOP could turn it around

Shopify has taken a beating this year. Partially, it's been with good reason. Although Shopify is a real company, it never deserved an infinite stock price. Its past growth was going to slow down sooner or later; when it did, investors lost interest.

The thing is, SHOP isn't really *that* expensive anymore. At today's price, it trades at 9.2 times sales and 5.8 times book value. It's still expensive — don't get me wrong. It's just not expensive by the standards of tech companies of its size.

This is why things might start looking up for Shopify when the central banks stop raising interest rates. Just like rising interest rates make growth stocks go down, falling interest rates make them go up. Or, to be more precise, falling interest rates "theoretically" make growth stocks go up. There are many on the ground realities that can cause that to not happen — such as a previously high growth stock losing its growth. But SHOP is still growing at 22%, which is faster than average. So, it has a good chance of turning around once the central banks start easing their policies.

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