Foreboding Signs of a Long-Overdue Market Correction

Description

The U.S. stock market has surged ahead in recent times, creating the second-longest U.S. bull market of all time. All three major U.S. stock indices hit record highs in recent weeks, and, despite the latest pullback, they are all still trading close to those all-time highs.

These events have transpired despite a number of indicators highlighting that stock values have disconnected from economic reality and that a correction is long overdue. Any U.S. correction would spill over into Canada, impacting Canadian stocks because of the interconnected nature of financial markets and the interdependent global economy.

Now what?

What is becoming increasingly clear is that financial markets are being propped up by the easy money coming from central bank money printing and artificially low interest rates. Since the advent of the global financial crisis in 2007, central banks have embarked on a spending spree, buying assets and keeping interest rates artificially low in an attempt to stimulate economic activity.

Such actions have flooded financial markets with cheap money and made credit extremely easy for corporations to obtain, allowing them to fund questionable acquisitions and aggressive share-buyback programs. These have only helped to further inflate stock valuations to what some pundits are calling unrealistic levels.

There are, in fact, signs that valuations are disconnected from economic reality. Despite the fanfare surrounding the U.S. economic recovery, it is becoming increasingly clear that it remains fragile. Indeed, it was only late last year that the Fed said that there was no conclusive evidence that quantitative easing had boosted real economic activity.

Consumer spending remains anemic; income for many households remains below where it was in the late 90s; business activity is constrained; and corporate earnings have declined. This suggests that eventually stock valuations will have to fall in order to reflect the underlying economic fundamentals, meaning that a market correction may be be around the corner.

So what?

It is becoming increasingly clear that the easy money and cheap credit created by quantitative easing has failed to stimulate real economic activity and instead has triggered a massive asset bubble which will eventually have to burst. When it does, it will trigger a U.S. market correction that will cascade across global markets, including Canada.

One of the best ways for investors to hedge against this is by investing in utilities. Demand for electricity, water, and gas remains unchanged regardless of the state of the economy, and cash flows are typically contractually locked in, adding certainty to earnings.

Electric utility **Fortis Inc.** (TSX:FTS) is among the best opportunities for investors. Virtually all of its assets are regulated, guaranteeing cash flows and making earnings highly predictable. It has also been actively acquiring other regulated utilities, expanding its operating footprint across Canada and the U.S. to give it two million electric and 1.6 million gas customers.

Now it is making considerable progress with the purchase of **ITC Holdings Corp.** (NYSE:ITC), the largest independent electric transmission company in the U.S. On completion, this acquisition will boost cash flows, giving its bottom line a solid boost.

More importantly, Fortis has hiked its dividend for the last 42 years straight, giving it a healthy 3.5% yield. In fact, it even increased its dividend during the global financial crisis that lasted from 2007 to 2009, which was a period when the majority of companies were slashing or even eliminating dividends altogether. The reason for this impressive performance is the relative immunity of its operations to economic downturns coupled with the predictable cash flows.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:FTS (Fortis Inc.)

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/08/24
Date Created
2016/09/29

Author
mattdsmith