

Is the Fed Responsible for Creating the Next Market Crash?

Description

The outlook for stocks remains subject to considerable conjecture with analysts and economists proffering conflicting hypotheses as to the state of the economy and what the future holds for financial markets.

Some claim that the global economy has started on the long road to recovery; commodity prices have risen, and there are signs that growth is returning to critical emerging markets. Others believe that global uncertainty will continue to fuel volatility in financial markets, and that a range of events have the potential to trigger the next market crash.

What appears increasingly undeniable is that unconventional monetary policy has created significant financial risks that could derail the U.S. economic recovery and trigger the next market crash.

Now what?

This policy essentially refers to the program of quantitative easing and artificially low interest rates implemented by the Fed to stimulate economic activity. The Bank of Japan and the European Central Bank also carried out similar policies in an attempt provoke growth.

While growth occurred in some sectors of the economy, the consensus among economists is that it failed to spur any growth in the real economy. What is becoming increasingly clear is that almost a decade of quantitative easing and near zero interest rate policy has artificially inflated assets prices.

Not only did quantitative easing pump trillions of dollars into financial markets, but artificially low interest rates made yield-based assets such as bonds extremely unattractive. The hunt for yield and higher returns caused investors to flock to growth-oriented assets like stocks and real estate. This was magnified by historically low near zero interest rates, making it extremely attractive to use borrowed funds to invest in growth assets and causing prices to surge further.

Even real estate mogul and U.S. president-elect Donald Trump has weighed in on the argument, claiming that the Fed's low interest rate policy has created a false economy.

The U.S. stock market does appear to be significantly overvalued.

The Buffett indicator, which measures market cap compared to U.S. GDP, for the third quarter 2016 moved to 125%, up from 120% for the previous quarter and almost double the long-term average of 70%. This is not the highest that it has been, but it does indicate that U.S. stocks are overvalued.

For these reasons the U.S. market has become especially sensitive to a rate hike, which would shut off the cheap funds that have propelled the market to record highs. There are also a range of other macro-economic dangers lurking domestically and globally. The U.S. economy looks good on paper, but there are many deep fault lines. These include rising underemployment, declining corporate earnings and low consumer confidence.

Then there are the fears of another European banking crisis as well as the failure of the E.U.'s own quantitative easing to pull the region out of its deep economic slump.

So what?

A U.S. market crash would certainly spill over into Canada, impacting the TSX. This makes it important for investors to hedge against such an event by investing in companies that hold hard assets, have wide economic moats, and strong defensive characteristics, such as **Brookfield Infrastructure Partners L.P.** ([TSX:BIP.UN](#))([NYSE:BIP](#)).

Brookfield Infrastructure owns and operates a globally diversified portfolio of infrastructure assets, including ports, rail, toll roads, telecommunications towers, and utilities located in emerging and developed economies.

Not only does it operate businesses in oligopolistic markets, allowing it to be a price maker, but the demand for many its assets will remain strong, regardless of the state of financial markets or the economic cycle. While investors wait for markets to rebound, they will be rewarded by its regular distributions that have an attractive 5% yield.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BIP (Brookfield Infrastructure Partners L.P.)
2. TSX:BIP.UN (Brookfield Infrastructure Partners L.P.)

Category

1. Investing

Date

2025/10/01

Date Created

2016/11/14

Author

mattdsmith

default watermark