Investors: Should You Be Readying Yourselves for the Next Market Crash?

Description

As equity markets rise ever higher, and with stock valuations at record highs, the chorus of voices claiming that a market correction is nigh continues to gain momentum.

Despite the optimism surrounding Trump's planned fiscal stimulus and expectations that the economy will expand at a faster rate than initially anticipated, there signals that dark times may lie ahead.

Now what?

Investors are witnessing a rare phenomenon. Equities**,** or, more specifically, U.S. stocks, have surged to record highs in recent weeks, and, more bizarrely, gold has also rallied.

Meanwhile, gold has risen to close to its highest price since mid-November 2016.

As a result, some analysts are claiming that a reckoning is due, and it is easy to see why.

The last time all three U.S. indices (the S&P 500, Dow Jones Industrial, and Nasdaq) simultaneously hit record highs was just before the dotcom bust. This wiped almost a trillion dollars off the market and cast the U.S. economy into a recession.

Causing even greater anxiety this time around is that gold, which typically is negatively correlated to stocks, continues to move higher.

According to some pundits, this is a dark portent of what is to come.

Not only does it highlight that the traditional relationship between asset classes is breaking down, but that stock valuations have decoupled from economic reality. It appears that the optimism surrounding Trump's policies and expectations of a massive uplift in economic growth are driving equity valuations.

Corporate earnings growth remains muted, and the spread between stock prices and GDP continues to widen.

The later point becomes apparent when considering a measure commonly known as the Buffett

indicator. It takes U.S. market capitalization and divides it by U.S. GDP to give a ratio which indicates whether stocks as a whole are overvalued or undervalued.
At this time, the ratio is at a sky-high 123%, or a whopping 53% higher than the historical average of 70%.

In fact, the ratio is now higher than it was in 2007 at the peak of the U.S. housing bubble and right before the greatest global financial catastrophe since the Great Depression.

What is even more worrying is that Trump's fiscal stimulus may not pass muster. Not only could a combination of tax cuts for wealthy individuals and corporations prove fiscally unsound, but the proposed trillion-dollar infrastructure plan would create a massive budget black hole.

Meanwhile, any significant uptick in the pace of economic growth would force the Fed to hike rates at an almost unprecedented rate. Along with rising wages, higher borrowing costs, and Trump's protectionist trade policies, this will only further fuel inflation, creating the very real danger of stagflation.

The only asset that has historically performed well during times of stagflation is gold.

The last time the U.S. experienced a significant bout of stagflation was during the Financial Crisis in the early 80s, which saw the yellow metal hit an all-time inflation-adjusted high.

Don't forget, there are also the dangers that Trump's anti-Liberal and isolationist policies will trigger greater global economic and geopolitical instability in a world already riven with economic and political fissures.

These factors make gold an even more attractive investment as a hedge against growing uncertainty and fear.

So what?

One of the most tantalizing opportunities is small-cap gold miner **Eldorado Gold Corp.** (TSX:ELD)(NYSE:EGO). Like all miners, its price is levered to that of gold, meaning that as the yellow metal rises**,** investors will receive outsized returns.

However, what makes it an appealing play on higher gold prices is that it has not benefited from the rally that has benefited many of its peers. This is because the market was worried about asset sales, declining production, and falling ore grades.

While these issues are of concern, Eldorado has embarked on a strategy of divesting itself of high-risk mature assets and using the funds generated to develop its lower-risk, higher-potential European assets.

Because of falling costs, improving ore grades, and growing gold production from this strategy**,** Eldorado is well positioned to unlock value for investors as gold prices rise.

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