Signs the Market Is Overdue for a Correction

Description

Not to crash anyone's party, but the **S&P/TSX Composite Index** (TSX:^OSPTX) is overdue for a correction.

Markets are ripe with uncertainty. That is a given, but what a lot of investors are forgetting lately is that markets can and do fluctuate. In other words, the incredible run that we've had in the market over the past few years, where the TSX is up an incredible 15% in the past year alone, is starting to show signs of running out of steam.

Here are a few signs that we may be overdue for a correction, and why that correction may not be as bad as you think.

The banks are getting edgy

Financial institutions form the backbone of the economy, keeping the wheels of commerce spinning. They also serve an important function in gauging the overall strength of the economy; for example, one can tell the strength of the economy by how much (and, by extension, how confident) the banks loan out, as well as how much money the banks stash away for a rainy day.

Approximately 35% of the TSX Composite is made up of financials, and while the Big Banks, such as **Royal Bank of Canada** (TSX:RY)(NYSE:RY), had a recent pull back, they are performing exemplary with double-digit gains over the past year more the norm than the exception.

The most recent quarterly update from the Big Banks can be summed up as beating expectations and increased dividend payouts. While this sounds good in principal, the banks have been performing well for some time now, which is part of the reason for that double-digit growth.

That past performance has led to higher expectations from investors and analysts, which is why the recent beat on earnings was not met with the usual surge in stock price. In other words, we're overdue for a reset.

The banks are a little overweight now, and at least one bank reported an increase in provisions for credit losses.

The looming bubble in housing

One look at the super-hot real estate markets of both Toronto and Vancouver should be enough for any cool-headed person to realize that we are in the middle of a real estate bubble that is overdue for a popping.

By way of example, the average price of a detached home in the coveted 416 area of Toronto is now over $1.5 million. That's a nearly 30% increase compared to the average price of a home in the same area last year. This has made current homeowners, particularly those that have owned since before the current bubble, salivate at the idea of selling their homes for seven figures and then upgrading to bigger homes.

First-time homebuyers, however, are being pushed out of the housing market altogether. To put this into perspective, the cash down-payment on one of those average homes in Toronto could nearly pay for a new condo in the downtown core. Better yet, selling that run-down Victorian-era bungalow could net you enough to move to another part of the country and pay for a mini castle.

In short, that level of growth is not sustainable, and we are well overdue for a correction here as well.

Would a correction be that bad right now?

It's all a matter of perspective, but I prefer to look back at what one of the greatest investors of all time, Warren Buffett, says on the matter: "...be fearful when others are greedy and greedy when others are fearful."

Following the Oracle of Omaha's advice, a correction of 10% or more on the market might not be that bad; it would represent a great time to buy into some stocks at truly incredible discounts.

That inevitable correction is nothing more than a normal cycle. As investors, we have to find a way to capitalize on it. I'm waiting for that correction to come and have my shopping list of stocks ready.

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Author
dafxentiou