



Ray Dalio Warns of 1930s-Style Global Recession: Should You Worry?

Description

Last week was a bad one for markets worldwide. Led by the Dow, which fell 546 points in one day, a number of indexes (including the TSX) stumbled in a five-day selloff. The TSX and most other indexes have since recovered, resulting in investors breathing a collective sigh of relief. But one hedge fund manager is saying the worst is yet to come.

Ray Dalio is one of the world's [most successful hedge fund managers](#). After correctly predicting the late-2000s recession, he went on to not only avoid damage, but actually grow his fund during that period. With a net value of \$18 billion, Dalio is among the world's most respected money managers, counting central banks and foreign governments among his clientele.

Dalio recently said that markets are overheating in a fashion that resembled the late 1930s—the period before the great depression—adding that a major crash is no more than two years away. And Dalio has a pretty good track record of forecasting economic trends.

His prediction has ramifications for all investors, especially those considering getting in the markets now. To understand what those ramifications are and how you should act, we need to look at the theory that has helped Dalio predict many recessions.

Dalio's theory of economic cycles

Ray Dalio is famous for his theory of economic cycles, which says that the “economic machine” repeatedly undergoes six phases: early cycle, bubble, top, depression, deleveraging and normalization. Basically, these economic cycles are similar to business cycles, only with a few extra details. For example, in the early phases of Dalio's model, it's rising debt levels that drive economic growth. Rising interest rates, which make people more wary of taking out loans, then lead to a recession.

Rising interest rates

According to Dalio, many phenomena being observed today are similar to things observed in the late 1930s: rising inequality, increasing populism, overheating markets and more. Among the most

significant? Rising interest rates. In the period before a recession, interest rates tend to rise, discouraging loans and thereby reducing both business and consumer spending.

As a result, companies begin to post lower earnings and investors begin to flee the market. Central banks typically then respond by cutting interest rates to stimulate borrowing, but a recession can continue for some time before monetary policy has any effect.

A recession-proof pick

Currently, the Canadian economy appears to be at the tail end of one of Dalio's growth phases after over eight years of steady TSX gains and interest rates set to rise this month.

Is there a pick that would do well if, as Dalio predicts, a major recession hits in two years?

One promising sector would be discount retailers. Dollar stores like **Dollarama Inc** ([TSX:DOL](#)) tend to sell dirt cheap daily necessities, the type of thing that people buy in times of recession. Dollarama specifically has [not being doing well this year](#) due to slowing earnings growth, but it could be a stock that at least doesn't get clobbered in a recession.

Depending on the severity of the recession, Dollarama may even see some earnings growth, as consumers cut out as many high-priced purchases as possible and replace them with cheaper alternatives.

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