Ray Dalio Warning of “Painful” Market Correction: Is He Right on the Money?

Description

The markets have been on a heck of a run in 2019. With the continued momentum showing no signs of slowing down in 2020, the risk of a correction is rising substantially. Market corrections (10% peak-to-trough drops) happen every year on average, and since it’s been more than a year since the last one, we’re overdue for a sharp pullback, even though the slate of worries has seemingly been wiped clean.

Now, nobody, not even Ray Dalio, knows where the markets are headed over the near term. As you may remember, Dalio stated that people would “feel pretty stupid” for holding cash amid a market melt-up in early 2018, right before the markets fell off a very steep cliff. The markets posted a full recovery several months later only to enter bear market territory (a 20% peak-to-trough decline) heading into the holiday season.

After the big 2019 rally, Dalio has returned, and it appears that he’s changed his near-term stance from FOMO-inspiring to cautious, with comments urging investors to be “be careful up here” and that the “risks of a painful correction” will go up in conjunction with the speed of the current upward move. Talk about a reversal of 180-degree reversal of sentiment!

Ray Dalio may be one of the smartest minds on Wall Street, but it was he who likely felt stupid for attempting to time the markets over the short term in early 2018. And this time around, the odds of another ill-timed call may be just as likely. Nobody knows!

The markets could soar right into 2020’s end, now that the dreaded recession is “off the table.” However, Dalio is right about the risks that will continue to rise the higher we climb. Like in rock climbing, the higher we climb, the farther we have to fall.

There’s no telling when our arms will tire out or when our grip will slip, but given we’ve already climbed to remarkable heights, it’d only be prudent to ensure you’re ready for a potential slip with a harness. Or in the context of investments, be ready with defensive or out-of-favour stocks that have not participated in this recent run-up, as it’s these such stocks that will serve to limit the damage you’ll endure in the next inevitable slip-up.

Fairfax Financial Holdings (TSX:FFH) is a stock that’s considered both a defensive bet due to the prudent nature of the firm's bets (Prem Watsa is all about downside protection with hedges), and an undervalued one given the stock has gone virtually nowhere for over five years.

The stock is down over 21% and is in bear market territory thanks to some less-than-stellar investments on Watsa's part and an underwriting track record that still leaves a lot to be desired.

In a prior piece, I'd noted that Fairfax is a top stock to hold if you're looking to mitigate some risks in your portfolio.

"I like to see Fairfax as an insurance policy against a market meltdown." I'd said. "And right now, the price of insurance is absurdly cheap, even given recent jitters that have been sending gold prices creeping higher. While Watsa is technically more 'bullish' than he's been in the past, he's still all about mitigating risks and consider the bull and bear scenarios that could unfold."

Fairfax may not have a lot going for it, but it's absurdly cheap right now with shares trading at just 9.4 times next year's expected earnings and only 1.04 times book. This defensive stock on its own is even more defensive given the wide margin of safety to be had at these valuations.

So, if you're looking to batten down the hatches to be ready for the next correction, whether it's next week or next year, Fairfax is the horse to bet on!

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