



Is the Stock Market Dangerously Overvalued?

Description

Stocks around the world have witnessed a resurgence this month. Since the stock market crash in March, nearly every single company listed on any stock exchange has rebounded. South of the border, the **S&P 500** trades at a record high. Meanwhile, the **TSX 60 Index** is down only 6% year to date.

This rapid escalation in stock prices flies in the face of what's happening in the actual economy. Millions of people are still unemployed, while the pandemic hasn't yet been resolved. In fact, experts warn of another wave of layoffs and infections in the months ahead.

With this in mind, investors must ask themselves if assets are overvalued and if we could revisit a stock market crash soon.

Leading indicator

Stocks are basically a leading indicator for corporate earnings. In other words, they don't reflect the present-day situation but investor sentiment about the future. The stock market crash of late March indicated the economic distress due to the lockdown orders spreading across the world. Now, the stock market is reflecting a quick rebound in the months ahead.

The stock market isn't always right. Investors can choose to disagree with the indications. I believe the sentiment about the months ahead is overly optimistic. A stock market crash could quickly reflect any future lockdowns or a slower-than-expected jobs recovery.

The current ratio of stock market-to-national income (the [Buffett indicator](#)) is 115%. Meanwhile, the national income in 2020 and 2021 could be much lower than the previous 12 months. In other words, the stock market is indeed overvalued.

Sector divergence

A deeper dive reveals that the stock market crash and recent rebound did not impact all sectors equally. Certain sectors were thriving despite the pandemic. **Dollarama**, for example, saw a surge in activity and avoided any lockdown during the height of the crisis. Technology stocks like

Shopify and **Absolute Software** also saw greater demand.

Investors retreated to these essential stocks during the crisis. However, this flight to safety has pushed valuations to unbelievable levels. Meanwhile, valuations for real estate and restaurant stocks have dropped below reasonable levels.

Brick-and-mortar companies are being underpriced while technology companies are being overpriced.

Any dislocation between investor expectations in the months ahead could trigger a stock market crash.

Another stock market crash

Another bear market — an over 20% drop in stock prices, can't be ruled out. In fact, even a 20% drop may not be enough to make some stocks fairly valued.

If you're worried about the economic recovery being slower than expected or a second wave of coronavirus cases in 2020, you should secure yourself financially. Invest in [hard assets such as gold](#) or place a portion of your portfolio in cash to mitigate the downside.

More cash and gold in your portfolio also allows you to buy assets cheaply if another stock market crash is triggered.

Bottom line

Stocks have quickly rebounded from their March lows. Now, the stock market and certain sectors such as healthcare and technology could be priced to perfection.

Unexpected risks are not being priced into the market. Another stock market crash can't be ruled out. Stay prepared by moving part of your portfolio to gold and cash.

CATEGORY

1. Coronavirus
2. Investing

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Investing

Date

2025/08/25

Date Created

2020/06/12

Author

vraisinghani

default watermark

default watermark