Billionaire Diaries: George Soros Warns of the Stock Market Bubble

Description

The stock market is moving in stark contrast to the economy. Billionaire investor George Soros calls it the liquidity bubble formed by the free money coming from the fiscal stimulus package. This liquidity bubble is driving the stock valuations to new highs. Hence, billionaire investors like George Soros and Warren Buffett are not participating in this stock market bubble.

The state of the economy

The **TSX Composite Index** surged 16%, while the real gross domestic product (GDP) contracted 11.5% in the second quarter. Canada's unemployment rate fell to 10.2% in August from 13.7% in May. But even the 10.2% unemployment rate is way above the peak of 8.7% in June 2009. It took the economy nine years to reduce the unemployment rate to the pre-crisis level of 6.2%.

Even though the GDP and unemployment figures are the worst since the 2009 financial crisis, the stock market has surged to its all-time high. The Justin Trudeau government spent $146 billion in direct support that put cash in the hands of Canadians. Hence, household disposable income increased by 10.8% in the second quarter, even when employee compensation fell.

In theory, when the government releases more money in the market, consumers should spend more and boost the GDP. But the recession also reiterates the need for savings, as uncertainty about the future discourages people from spending. Even though household disposable income increased in the second quarter, spending fell 13.7%, and the savings rate surged to 28.2% from 7.6% in the first quarter.

Now, where did this savings money go? The central bank has lowered the interest rate to 0.25%, making fixed-income securities unattractive.

The stock market bubble

As investors had no other attractive security to store their money, they invested their money in the stock market. The huge cash inflows in the stock market pushed equities to new highs. According to the Buffett Indicator (GDP divided by the market capitalization), equities are overvalued by more than 80%.

Not all equities surged to lofty valuations. The virus stocks that facilitated the move to the digitization and got sudden traffic surged to unprecedented levels. Even gold stocks returned to significant growth after falling for eight years since the 2011 recovery from the financial crisis.

A good example is that of **Shopify**, which surged from $40 billion to $136 billion to become the highest-valued stock trading on the Toronto Stock Exchange. It is trading at 23 times its book value and 51 times is sales per share. This valuation might seem extreme for a company that is yet to report stable profits. But there is a strong argument that the company is growing its revenue at a CAGR of 50%, and the pandemic just accelerated this growth, making it a good stock to hold on to.

Canada's largest gold producer **Barrick Gold** (TSX:ABX)(NYSE:GOLD) stock surged 65% year to date. Investors buy gold to hedge against inflation.

The huge sums of money that the government released in the market as stimulus did not spur consumer spending, because of which inflation didn't rise. But investors fear that when this surplus money starts circulating in the economy, inflation will rise and gold can safeguard your investment. Hence, Barrick Gold stock price surged 90% between October 2008 and November 2011, despite the ups and downs.

How to play the stock market bubble

But what concerns me is that none of the billionaire investors participated in the stock market rally between April and August. Buffett sold some of his bank and airline stocks. He is sitting on a large cash pile and hedging his portfolio with energy and gold stocks. George Soros is hedging his portfolio by investing in market ETFs.

Follow in the footsteps of these informed investors and divide your portfolio into three segments: gold stocks or ETFs to hedge against a downturn, growth stocks to enjoy the current rally, and dividend stocks to earn some cash in the downturn. Also, keep some liquidity to grab the opportunity to buy quality stocks in another stock market crash.

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