



## Is the Stock Market Bubble Set to Burst?

### Description

A stock market bubble is by no means a new phenomenon. Looking back at the track record of global equity markets shows that there has always been a cycle that includes periods of growth and periods of decline.

The recent stock market rally could cause investors to consider whether a crash is now imminent. However, such events can be very difficult to predict.

As such, a strategy that aims to buy undervalued shares for the long run where they are available could be a logical approach. It may allow for strong growth in the long run, as well as some relative protection from a potential market crash.

### Predicting if a stock market bubble will burst

Despite the recent stock market rally, identifying a stock market bubble that is ready to bust can be a challenging task. After all, there appear to be some companies that continue to trade at low prices even after the recent recovery. For example, sectors such as financial services, retail and resources could contain companies that have low valuations as a result of weak investor sentiment and an uncertain economic outlook. This could mean there are still buying opportunities on offer.

Furthermore, the stock market's performance is very difficult to accurately predict. Certainly, it has a long track record of delivering high single-digit annual total returns. However, those returns are very unlikely to be linear. They include periods of growth and decline that themselves are dependent on a wide spectrum of factors that are tough to forecast on a consistent basis. This could mean that a stock market bubble increases in size, or bursts, in future.

### A logical approach after a stock market rally

Given the difficulties in predicting whether a stock market bubble will burst or not, it may be prudent to instead focus on purchasing undervalued shares. They may offer a combination of low prices and high-quality fundamentals, such as strong balance sheets and resilient cash flow.

Not only may they be less impacted by a stock market crash because they are priced at low levels, they could outperform their sector peers in a bull market or bear market. For example, a high-quality business with a wide economic moat may have more resilient sales in a downturn. Equally, it may be able to generate higher margins and profit growth that is reflected in a faster-rising share price during a period of stock market gains.

## A long-term view

Clearly, no company is guaranteed to escape the bursting of a stock market bubble. Falling share prices can lead to deteriorating investor sentiment that pulls down even the most attractive stocks.

However, stronger businesses purchased at appealing prices can be a sound means of generating impressive total returns. When held for the long run, they could offer relatively strong performance compared to sector peers and the wider stock market.

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