This 1 Indicator Shows the Stock Market Could Be Overvalued

Description

Stock market investors don't have the motivation to purchase stocks when equity valuations are high. Veteran investors like Warren Buffett know what he speaks of when he warns stock prices could plummet. Investors use the American billionaire's gauge to determine the market's valuation.

The so-called Buffett Indicator is the ratio of the stock market size vis-à-vis the economy. When the ratio is high, it means you have an overvalued market. The most recent mark was 123%, eclipsing the 121% record during the dot-com bubble. According to Buffett, it's a very strong warning signal if his yardstick posts a record high. It happened just before the dot-com bubble burst, and it may happen again in 2021.

Three-way measure

For computation purposes, investors use the Buffett Indicator to gauge whether the market is overvalued, fairly valued, or undervalued. For computation purposes, they divide the collective value of a country's stock market by its GDP. You're playing with fire if the ratio nears 200%.

The GDP data must be reliable and current to be accurate. Some market observers say the Buffett Indicator's shortcoming is that it compares current stock valuations to past GDP figures. Also, it's hard to ascertain the accuracy during the health crisis.

Economic growth is stagnant because of the pandemic-induced lockdowns, business closures, and travel restrictions. Government transfers or interventions are artificially buoying stock prices. Some investors remain upbeat because of the historically low interest rates, especially if the level stays low for the foreseeable future.

The argument is that when interest rates are low, future real earnings worth more, theoretically. Its impact on the stock market should be positive. Stocks benefit from low interest rates because low-risk bonds, for example, offer smaller returns. The current environment boosts stock prices. Buffett even suggested recently to steer clear of fixed-income instruments.

Bargain deal

If you're bargain hunting, **Real Matters** (TSX:REAL) is perhaps the most undervalued TSX stock. The business is doing great, yet the stock is down 26.13% year to date. Over the last three years, its total return was an incredible 94.65% (24.81%). Real Matters was also the top performer in 2019.

The $1.21 billion company from Markham, Canada, provides residential real estate appraisal and title and closing services to mortgage lenders in the U.S. and Canada. Its revenues are more across the border than in the home country. The company-developed proprietary technology is the edge or competitive advantage over traditional service providers.

Real Matters's fiscal 2020 business performance already bested fiscal 2021 targets. The company is forward looking and has set its sights on fiscal 2025. This year, management expects the U.S. appraisal market share to be between 15% and 20%. No wonder analysts project the tech stock to soar 124% from $14.19 to $31.81 in the next 12 months.

Pay attention

The Buffett Indicator could be right or wrong. However, it successfully predicted the most distressing economic downturns in the United States. Some analysts follow the trend to analyze whether a disaster loom. But as mentioned earlier, the indicator is likely to remain high if interest rates stay at record lows.

Nonetheless, it won't hurt to pay attention to the Buffett Indicator. The situation appears manageable at this time, although history could still repeat itself.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. TSX:REAL (Real Matters Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Investing
2. Tech Stocks

Date
2025/08/28
Date Created
2021/04/02
Author
cliew