Are We in the Midst of a Massive Bubble? What Happens When it Pops?

Description

Given where valuations are today in the market, concerns are brewing that we're in the midst of a massive bubble.

Indeed, using the "Warren Buffett greed indicator" as a benchmark, valuations right now are disproportionately high. As a percentage of GDP, the value of the overall stock market is at a level we haven't seen historically.

Now, interest rates are also near historical lows. We're seeing capital flowing into the stock market for one simple reason: investors can't get a decent enough return holding other fixed-income assets right now. Accordingly, questions about just how viable a traditional 60/40 portfolio is today are valid.

How do we unbundle this mess?

Well, let's take a look at what sort of factors investors should be looking at right now.

What puts us in a bubble?

Historically speaking, when valuations become detached from fundamentals is broadly when bubbles get called. In this regard, what we can see happening with stocks like **AMC Entertainment** or **GameStop** could certainly qualify as stocks that would fit in the bubble discussion.

Speculative fervor and get-rich-quick schemes tend to funnel a lot of money into such places over the near term. A sharp spike upward (which as we've seen and can be maintained for some time) is almost always followed by a catastrophic drop. Thus, investors are really playing with fire with such plays.

Aside from meme stocks, the broader market has seen the "TINA" (there is no alternative) trade play out in a big way. The extent to which money is being pumped into the market, because it has no better home is a reality we're in right now.

However, what happens if interest rates rise? Should bond yields go to 3% tomorrow, I'd think a lot of money would flow out of the market — perhaps faster than it flowed in.

Such is the conundrum investors are in right now. Time in the market beats timing the market. However, when we're looking at the valuations stocks are garnering today, there's certainly reason to be cautious today.

Should investors be worried?

There will always be pockets of the market that are overvalued. Bubble territory or not, some stocks see valuations get ahead of their long-term earnings potential. And such stocks should be avoided by those practicing proper risk management in their portfolios.

However, the inverse argument can also be made for stocks that are trading well below where their fundamentals suggest they should be trading. These pockets of value are really where investors should spend most of their time diving into today.

Top pick to consider today

One such pocket of value I think isn't getting enough attention right now is in commodities — more specifically, precious metals and precious metals miners.

In this group, my top pick right now remains **Kirkland Lake Gold** (TSX:KL)(NYSE:KL).

Not only does Kirkland Lake provide investors with a nice hedge, but it's clearly an undervalued stock. Gold miners aren't sexy. They've been beaten down in recent years for good reason. And now, they're trading at valuation multiples that are historically near rock bottom.

Thus, long-term investors looking to combat overvalued equities can start by looking for value. Indeed, if a growth-to-value rotation continues, such stocks will do very well.

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chrismacdonald