Warning: A New Danger Is Emerging in China

Description

China seems to dominate the news cycle every few months, which is why it's difficult for investors to separate the signal from the noise. In other words, Canadian investors may overlook how important some economic indicators from China really are.

This week China's bond market seems to be sending an important signal for global investors. Here's what you need to know about what comes next and how you can protect your portfolio.

China's bond market

China's junk bond or high-yield bond market took a serious plunge this week. The market is dominated by corporate debt from borrowers who have mediocre credit ratings. This week, the yield on such debt hit 25%, wiping out more than a third of bondholders' wealth.

Experts believe the sell-off is the result of **Evergrande's** credit problems spreading to the rest of China's economy. For some context, Evergrande was China's largest real estate developer and real estate accounts for roughly 25% to 30% of the nation's economic output.

In other words, the debt explosion in Chinese real estate is now spreading to other industries. Bonds have already dropped and stocks could be next. And some believe that the contagion could spread beyond China.

If there's a stock market correction and recession in the world's second-largest economy, global investors (including Canada) could be affected. The global economy is simply too interconnected to avoid damage from China's ongoing credit crisis. It could look like 2008 all over again.

What can you do?

If we face another stock market crash and economic slowdown, there's little you can do. The ideal strategy is to hold some cash on the portfolio to prepare for the correction. Warren Buffett seems to be applying this strategy as his cash hoard surges to US$149.2 billion (C$185.5 billion). Buffett was also hoarding cash heading into the 2008 crisis.

However, if you're worried about inflation a better bet could be hard assets or value stocks. **Northwest Healthcare REIT** (TSX:NWH.UN) is a good example. The company owns and manages real estate for the healthcare sector. Hospitals and clinics are essential businesses that are disconnected from the rest of the economy. This means Northwest can expect to collect rents even during an economic crisis.

The stock is also undervalued. It's currently trading at 9.5 times earnings per share and 1.4 times book value per share. That means there's limited downside risk.

Investors worried about an imminent crash or contagion from China's credit issues should consider adding some exposure to this undervalued, robust real estate company.

Bottom line

China's bond market is flashing red signals. A significant drop in the bond market could impact Chinese stocks and perhaps even global stocks. Canadian investors should consider ways to limit the downside risks. Cash or hard assets could be the answer. Stay safe!

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