Equity Market Rally

Markets rarely ever move in straight lines. Regardless of fundamentals, it was irrational to believe in February 2009 that equity markets would sink to zero. In early March, equity markets rebounded and are on an almost constant upward incline. Beware.

We now speak of distressed valuations supporting a more constructive outlook. We talk about the green shoots of recovery in the world economy. Banks are coming off life support of their own volition.

Economic fundamentals remain poor. Unemployment remains a significant problem. Consumption has not recovered. Sovereign balance sheets are highly stressed and public sector debt has grown exponentially, this at a time when healthcare and social security shortfalls were growing pre-crisis in any case.

Just as the rebound in March 2009 was missed by most investors, an impending sharp correction is likely to be missed by most.

This is not to say that there is not a recovery underway. Economies, particularly free market, unfettered economies, heal themselves, and often faster than people think, in ways they least expect. Even if a recovery is underway, and I believe there is, but more of this in another post, markets have got ahead of themselves and of fundamentals. A correction is now a very real possibility. Given the level of uncertainty still hanging over the real economy, over the health of sovereign balance sheets, over inflation-deflation, its likely to be a sharp one.

Why now? Because the level of complacency has risen, the balance of bulls to bears has swung to the side of optimism once again, and the justifications for a sustained recovery being put forward are grasping at straws, notwithstanding that there are reasons for optimism.