Ghost of global financial crisis may come back to haunt investors

Although the markets have recovered well since the start of the global financial crisis (GFC) 10 years ago, investors could still be in for a rough ride, as the debt overhang that sparked the worst economic disaster in modern history has yet to be resolved.

Maarten Ackerman, chief economist and advisory partner, Citadel

The extremely loose monetary policy and government borrowing over the past decade has seen global debt increase to the highest levels in 50 years, most of which is now lying with higher risk companies and countries, says Maarten Ackerman, Citadel chief economist and advisory partner.

The GFC was first caused by reckless lending practices in the United States (US), where banks granted individuals even in poor financial positions (such as students) access to mortgages. These subprime mortgages were then repackaged and sold to other financial institutions around the world as higher yielding investment opportunities. As interest rates started rising, however, US homeowners increasingly began to default on their mortgages, eventually bringing global institutions to a crisis point.

In response to the crisis, the US, and later Europe, attempted to stimulate and revive their economies through government spending and lowering interest rates to decade lows.

“However, low interest rates meant that the debt that caused the GFC was simply transferred from consumers, who took the opportunity to pay back their loans and deleverage their finances, to companies and countries that were lured by the temptation of ‘cheap’ money,” says Ackerman.

Over the past two years, the US has begun the process of normalising monetary policy by hiking interest rates, causing the dollar to strengthen and making this debt more expensive. This in turn has gradually exposed those countries with too much dollar-denominated debt and poor macroeconomic fundamentals.

“Argentina and Turkey have been among the first to show the cracks, and the emerging market turmoil experienced over the past few months clearly demonstrates that the legacy of debt left by the GFC will become problematic again as interest rates rise,” he says.

“We’ve been in a 10-year recovery thus far, but this recovery won’t continue forever. And while we haven’t yet seen the full impact of the debt burden left by the GFC, recent events such as the emerging market sell-off do point to tough times ahead.

“Investors therefore need to start preparing for a possible correction in the market, beginning with assessing whether they have an appropriate balance of wealth preservation and wealth creation assets within their portfolio.”

Preparing for a market correction

Ackerman notes that strong US fundamentals should continue to support global economic growth over the next 12 months, and that investors should still be able to achieve positive returns.

“However, rising interest rates will have the effect of introducing heightened market volatility and reducing global liquidity which, in turn, is likely to cause a slowdown in global economic growth within the next 18 to 24 months, with a heightened risk of a recession towards the beginning of 2020.

“Investors can therefore also expect to see returns slowly receding and market volatility increasing,” he says.

To protect their assets against a possible correction in the market, investors should seek to optimise the wealth preservation and wealth creation assets in their portfolio by matching their assets to their cashflow requirements.

“This means reassessing your balance of low-risk assets that you may need to access within the next five years, with growth assets that can be left invested for periods of five years and longer through any market corrections and rebounds,” explains Ackerman.