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The next global recession: why this time it is (really) different…

By George Salapa

U.S. stocks and bonds are at all-time highs in a relentless 'melt-up' that seems to ignore anything you can throw at it: Iran, Hong Kong or the Trump's war on China mean nothing. It's the longest bull run in history, surpassing its 10th year in December.

How long can this go on? …and are we at the peak yet?

Certainly, it doesn't comfort anyone that some of the most respected investors of all times have turned to prolific writers on the subject. Ray Dalio, for one, seems to be on a march to prove everyone that we are at the precipice of an epic social meltdown.

John Templeton famously warned of the four most dangerous words in investing ("*this time it's really different*") in 1933. Since then, people couldn't stop, but trying to come up with reasons why ***it is***.

So, is it this time? Well, it's not impossible. Even John Templeton admits that when people say things are different, 20% of the time they are right.

It is hard to put finger on anything systemic that could cause the next recession. Instead, something much more sinister is lurking under the surface — the colossal levels of cheap money in the system. All this easy money is looking for home, being pushed into all asset classes in investors' desperate search for yield. Markets are 'melting up', propped by the free money. It is sinister because we don't control it, nor do we understand it — we don't have a historical precedent for it.

Feeding off the historically low rates, corporate debt is up 50% from the 2008 levels. All of this debt is funded by insurers, pension funds and other institutional investors who have been forced to push their money into private markets because the rates on treasuries and other government debt are so low that they simply can't fulfill obligations to their customers.

As a result, corporate debt is cheap, very cheap. Tesla's $1.8 billion high-yield bond just touched its full face value again this week, meaning demand for corporate debt is surpassing all expectations again, and companies can fund their growth at near zero rates.

It is a C-suite dream come true: management is using cheap borrowed money to fund buybacks and acquisitions, further propelling market prices to all-time highs. All this does, of course, increase risks of a sudden deep collapse should there be a change in rates pushing thousands of zombie companies into delinquency in what could become a self-feeding downward spiral.

But how could this happen?

There is nothing structural that could cause such a reversal. We are all hyper-alert to any signals that the next recession is coming. The 2007/08 crisis has left us with deep scars, and thanks to its cataclysmic nature, it was also a great topic in a new world dominated by the rise of social media. This near paranoia feeds through all levels of society, so that regulators and authorities feel acute need to prevent and stop any wrongdoing.

Nor does the economy show any signs of overheating. Yes, it was the longest, but also the slowest bull market in history. In FED's chair Jerome Powell own words: "*There's nothing that's really booming that would want to bust,*

… ”. For now, FED has absolutely no reason to be concerned about inflation that would force it to start hiking. Wages simply can’t pick up despite low unemployment levels. Numbers show that jobs are being added in the lower-earning groups. Better and newer technology means that same amount of work can be done with fewer people, a phenomenon that is increasingly finding its way to higher-skill jobs. There is also the argument that consumers are cleverer and less demanding: the mantra of the post-2008 age is *less is more*.

Yes, everything seems to be ticking along just nicely. But wait a minute…

A lot of that record corporate debt we’ve mentioned above comes from private investors: private equity groups and other institutional investors. Should things really go bad, delinquent companies would fall right back to private hands. What this means in theory is that even in case of a large public default, it shouldn’t get contagious, as it would stay on private books.

But that doesn’t solve anything, does it? When WeWork failed its IPO, it fell right back to Softbank’s hands. And what did they do? Print more money (Softbank is planning to issue $3 billion loan to mend WeWork’s failure).

More importantly, WeWork’s debacle shook the market to its core, not due to its size, but because of its structural significance. Private investments in venture capital have been the primary source of gains for large investors in the post-crisis years. In the era of free money, the creeping realization that the likes of WeWork and UBER may not be worth their ballooned valuations is troublesome because they were the last bastion of superior returns.

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So, it’s different this time, but **it is not**. Crises are certain; they are inevitable like death and taxes because we are all driven by the crave to earn superior return. It is human to chase sensations. Last time it was the subprime mortgages and derivatives that no one understood; this time it is the tech sector.

We all needed some excitement after the depth of 2007/08, and the start-up economy gave us just that — the promise to create an infinitely more efficient and cleaner way of doing things, exchanging factories and steel for smartphones and abstract products.

It all went well until now. Companies like WeWork and UBER have become the religion of future, and people forgot to value them on the cold basis of profits & losses. They have freed themselves from the dryness of discounted cash flow to take the investors on a trip to forever, growing to billion-dollar valuations buoyed by private money.

Scarred by 2007/08, people are looking for the next big short; the next Collateralized Debt Obligation that could bring the market down. But there might not be one this time round. All crises are caused by some form of a market bubble; a moment when no price is too high, which eventually leads to a reversal and a downward spiral. WeWork, UBER and other utopian giants have infected markets with a profound belief that they are about to revolutionize world. Cash-burning giants with a zero cost of capital.

Their eventual (and unavoidable) collapse may prove to be systemic, dragging down the market, not because of their size (which is insignificant), but because investors will reprice the market, taking **the promise of infinitely more efficient tomorrow** out of the equation.

Ray Dalio’s dark prophecies may just be right: when the ‘dream companies’ (UBER, WeWork) fail to deliver on their promise, and the only way for pension funds to make good on the obligations is to chase debt, there might be a moment when investors say *enough* and began pulling their money out of the system, causing massive repricing and a surge in rates.

It would be impossible to time exactly when this happens, although Dalio seems to be trying to do just that — his fund is rumored to have bet $1.5B against the stock market in November.