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## 5 Investing Bubbles

by Stephen Gandel, Contributor  
Monday, August 23, 2010

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Even after multiple crashes, investors still tend to pile into overheated sectors. Where are the biggest risks today?

### 'A Fantastic Time for Bubbles'

Investors have lived through the calamitous crashes of real estate and tech stocks in a single decade. You'd think we would have learned to avoid the sort of frenzied enthusiasm that causes an investing category to see its value inflated beyond all reason. Alas, that is almost certainly not the case.

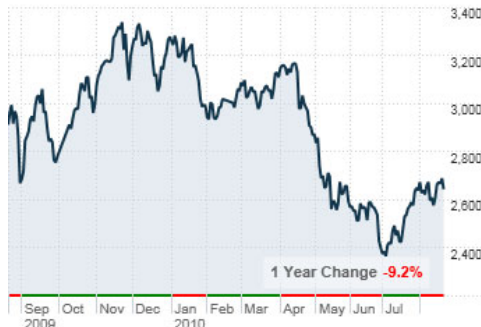
Didier Sornette, who studies bubbles and is a professor at the Swiss Federal Institute of Technology, says low-interest-rate, low-return environments, where everyone is looking for safe havens (sound familiar?), are perfect for new investment manias. "This is a fantastic time for bubbles," says Sornette. "Right now there is not one bubble, but many, in our analysis." With a surprising quantity of investing categories looking excessively frothy, Fortune decided to examine some of the leading suspects -- and a few unexpected ones.

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### The Chinese Economy

#### Shanghai Composite



#### Why It's Hot

A decade-long boom has lifted many of China's 1.3 billion citizens out of poverty, spurring epic consumption and building. As a result, China's stock market has risen nearly 300% over the past 15 years.

#### Why It's Worrisome

Much of that building and spending has been funded by debt. Last year Chinese banks made twice as many loans as they did in 2008,

boosting lending by the equivalent of 29% of GDP. Housing prices continue to rise despite reports that 65 million dwellings in China are vacant.

#### Verdict: A Bubble

Cracks appear to be slowly forming. China's stock market is down this year, and in July its manufacturing expanded at the slowest pace in 17 months. China's central bank has tightened its policies in an effort to rein in risky lending. Some savvy investors, including short-seller Jim Chanos, have turned bearish. Chanos said in April that China "is on a treadmill to hell."

### U.S. Treasury Bonds

#### 10-year yield



#### Why They're Hot

At a time of economic uncertainty, investors want safety. U.S. Treasuries may no longer be viewed as impregnable, but they still inspire more confidence than, say, Greek government bonds.

#### Why They're Worrisome

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Supply is supposed to bring down prices, but that hasn't happened: U.S. bonds have risen 14% in 2010, even as the government has issued \$3.3 trillion in debt over the

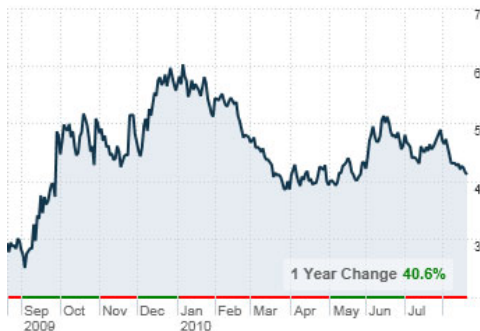
past two years. "This is the big one," says Doug Noland, senior portfolio manager at the Federated Prudent Bear Fund. "Bubbles happen because there is no restraint on borrowing, and that's exactly the situation we have now for the federal government."

**Verdict: Not a Bubble**

The national debt is still a manageable 40% of GDP. Economists warn that growth will slow when it reaches 90% of GDP. The Congressional Budget Office projects it will take nine years to get to that level, and that's if Washington, which is debating the deficit, does nothing.

**Pure-Play Shale Stocks**

**Natural gas**



**Why They're Hot**

Shales, massive rock formations deep below ground, may hold enough natural gas to satisfy U.S. needs for the next 45 years. Pure-play shale companies such as Range Resources (RRC) and Southwestern Energy (SWN) have seen their stocks rise 72% and 160%, respectively, over the past five years.

**Why They're Worrisome**

With gas prices already low -- \$4.30 per million BTU -- these discoveries will add supply and further depress prices.

**Verdict: A Bubble**

Environmental fears are fueling opposition to shale drilling. New York, where the massive Marcellus shale is partially located, is considering a temporary ban. Yet Range (a large Marcellus leaseholder) has a price/earnings ratio of 65 based on 2010 earnings, a huge premium to such diversified gas companies as Chesapeake and Devon, which have P/Es of 7 and 11, respectively. "Everyone is betting gas prices will go up," says Oppenheimer analyst Fadel Gheit. "But I don't see it."

**Cotton**

**Cotton**



**Why It's Hot**

Hold on to your shorts. Seriously -- they might be worth something. Cotton prices have nearly doubled in the past year to 80¢ a pound. The world has been using more but producing less. Last year's U.S. cotton production dropped to 12.2 million bales, the smallest crop in 20 years. And rising populations are causing nations like China and India to devote more land to foodstuffs and less to cotton.

**Why It's Worrisome**

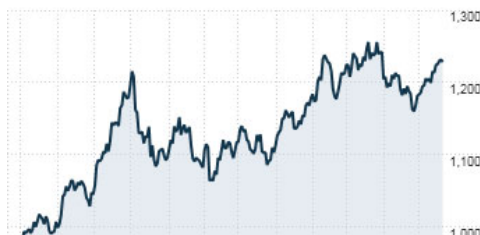
The two-year run has given farmers plenty of time to ramp up production, which means more cotton will soon be on the market and lower prices will follow. The USDA estimates that U.S. production will hit 18.6 million bales this year, up 50% from a year ago.

**Verdict: A Minor Bubble**

Analyst Sharon Johnson of First Capital Group says cotton has traded around 50¢ a pound for much of the past decade. When cotton has spiked above 80¢, it hasn't stayed there for long. "Prices are overvalued," she says.

**Gold**

**Gold**



**Why It's Hot**

Gold was rising even before the recession. But panic over world markets and the health of European and U.S. economies propelled it into the stratosphere. Prices have risen 150% in the past five years, repeatedly setting new records. Meanwhile, small investors have



stormed in. Some fear that stimulus spending could lead to massive inflation; they believe a tangible material like gold will hold its value better than other

assets.

**Why It's Worrisome**

Inflation isn't rising. It's falling and likely to be restrained for some time by a tepid economy.

**Verdict: A Major Bubble**

Gold has already started slipping. It declined 6% in July to a recent \$1,160 an ounce. Some economists are warning that continued weakness could lead to deflation. If that happens, expect gold to crater.

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**Fearless Leader** 7 minutes ago | [Report Abuse](#) 1 0

The 40% number is a trick on the way the author is recognizing the debt. He is discounting the debt owed to Social Security, which congress has been looting for 40 years. One you pull out those in house IOU's, you are left with the "public debt" of about 40%. I do not agree with that view, but it's just an FYI...

[Reply](#)

**George** 13 minutes ago | [Report Abuse](#) 1 0

I can't understand the claim that our national debt is only 40% of GDP. As others have pointed out, it is almost 100% of GDP. That does not mean that bond prices will fall any time soon. But they will eventually.

[Reply](#)

**Citizen 1** 18 minutes ago | [Report Abuse](#) 3 1

In what have we "invested" our so called "money"? Tanks, airplanes, military officers with medals and ribbons hanging on their expanded chests, drones, private security contractors, military bases, etc.etc. Only a few of our elected representatives discuss the subject of the faltering of the US economy and accumulation of huge deficits as a result of the military spending. Tell me what will we "win" in Iraq and Afghanistan, Don Pardow? Nada, Nil, Nothing. And what have our Ivy League Idiot Presidents done during the past twenty years, INCLUDING BALACK OBAMA---ramped up the "wars", increased the military and "security" spending and bankrupted the country. Where did your money go? Go watch a "military parade" or one of the innumerable "military bands." There is it, dressed in uniforms. Hail Caesar! Meanwhile we have more than enough housing for our population, but guess what, as countless houses sit unoccupied as a result of our inability to "afford" them. And why again did my government attempt to prop up the price of houses at taxpayers' expense? Why did my government borrow hundreds of billions to "bail out" GM and Wall Street? Is it because the Wall Street battalions do not earn enough? Is it because the GM executives and UAW workers do not earn enough? How much do you earn?

[Replies \(1\)](#)

**A Concerned Father** 34 minutes ago | [Report Abuse](#) 6 4

National debt only 40% of GDP? It's already at the red-line level of 90%. Look up the figures yourself. National debt is above \$13T, and GDP in 2008 was about \$14.5T.

It figures. Wall Street crooks (yes, I said CROOKS) are so used to lying they don't even blink.

[Replies \(4\)](#)**Ron** 35 minutes ago | [Report Abuse](#) 4 0

Bubbles always burst long after you think they are going to burst and just as you give up bucking the crowd and think they will never burst

[Replies \(2\)](#)**PaulM** 41 minutes ago | [Report Abuse](#) 6 2

Price of gold is up 351% over the last ten years, S&P 500 Index is down 6% in the same decade.

Numbers don't lie folks, and gold has been kicking the stock markets @#\$\$% for over a decade now and they way the world is headed it shows no signs of slowing down anytime soon.

Keep buying paper suckers.

[Replies \(3\)](#)**Michael** 45 minutes ago | [Report Abuse](#) 6 0

Hahaha ! I agree with previous posts. This guy has no idea what he is talking about. He doesn't know what a bubble is. And don't worry about any deflation, not even in short term. Even if stock market crashes, you will see no price decline in the real world, on Main Street. Did you see any "deflation" through your window in 2008 when world markets crashed 50 to 80% ? No. Except for real estate in US, the cost of living kept going up all over the world. That's because high MONEY(supply) inflation. Since then trillions of new \$ have been printed. In 2008 paper/electronic silver dived from \$20 to below \$8. But did you see any REAL silver, on Main Street, available to buy below \$16 ? Maybe a bar or two, but not a coin.

So, stay away from any paper, buy everything physical (metals, food, ammo, whatever) and you will see no deflation of your assets. Unfortunately Wall Street and Main Street are two totally different worlds these days !

[Reply](#)**RobertK** 1 hour ago | [Report Abuse](#) 14 1

"U.S. Treasury Bonds  
Verdict: Not a Bubble

The national debt is still a manageable 40% of GDP."  
What? The national debt is over \$10 trillion! Since when has the GDP been over \$20 trillion? Never. LIARS! Treasuries are in a colossal bubble.

[Reply](#)**Richard** 1 hour ago | [Report Abuse](#) 6 1

A couple of points:  
Governments printing more money than they actually have is the very definition of monetary inflation and we are burning up the printing presses. Gold has never completely lost value, but any stock, bond or mutual fund can have zero value. Gold is less an investment than a hedge against monetary inflation and something that will still have value when everything else has collapsed - be careful about using a growth rate of gold that goes back to before the USA came off the gold standard- not realistic.

The bottom line is that people are very nervous about the economy and tend to put their money in tangibles like gold and land, which will retain some value no matter what happens. But if you are looking for growth in your portfolio, you better understand some basic principles - read Benjamin Graham's books. Long term choices in solid companies - don't buy any stock you are not willing to hold on to for the long term. Don't try to time the markets or you will buy high and end up having to sell low.

[Reply](#)**Phil S** 1 hour ago | [Report Abuse](#) 3 4

Personally I think PORN stocks will go through the ROOF, aside from Cotton it's America's only big export right now. People will not have any money for real world entertainment, they'll just plug it in...literally...SO,