FINANCIAL REVIEW

The 'big sag': Why investors have lost their risk appetite

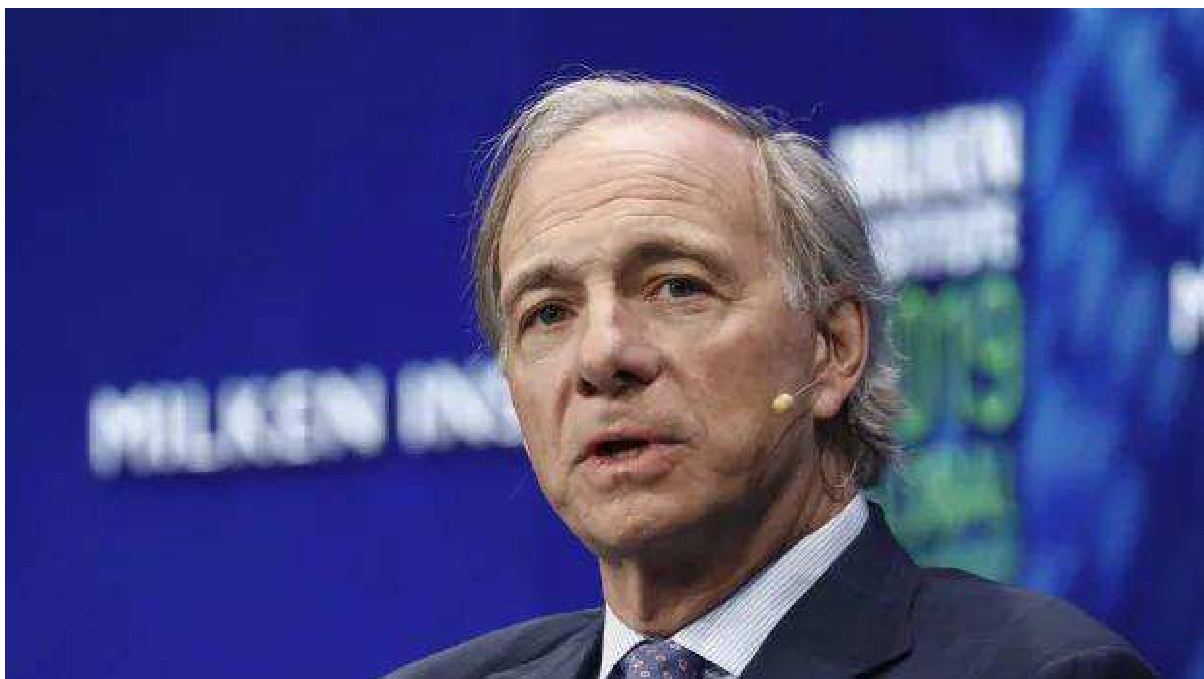
Karen Maley *Columnist*

Oct 21, 2019 — 12.00am

Billionaire hedge fund founder Ray Dalio probably didn't have either WeWork or Latitude Financial in mind, but his warning that the global economy is heading for a "big sag" pithily sums up the market's risk-taking appetite at present.

Speaking as part of a panel discussion in Washington last week, the founder of the world's largest hedge fund, Bridgewater Associates, said the business cycle was fading and that the global economy was headed into what he called a "great sag".

"This is the best that we get – this moment. We are at the best. The cycle is not going to continue forever, the expansion. You have this sag," he said.



Ray Dalio, billionaire founder of Bridgewater Associates, is warning of a "big sag" in global growth. **Bloomberg**

He added that this time around monetary policy is "not going to be so effective" to counteract any downturn, because central banks have already leant so heavily on ultra-low interest rates and bond-buying programs.

"I think that that's the landscape broadly speaking in the world and we are in that kind of self-reinforcing sag.
"Because as ... China slows and the United States slows – and they all have their headwinds – that makes it not as good for the others who deal with those countries."

Mr Dalio made the comments the day before China released figures showing its economy grew at 6 per cent in the third quarter of 2019 compared with a year earlier, its slowest pace in about 30 years.

Meanwhile, investors expect the US Federal Reserve will cut interest rates when it meets at the end of the month in response to growing recessionary risks amid faltering business investment and worrying signs that consumers are beginning to waver.

That creates this big sag more than it's likely to create a big bust.

— Ray Dalio, Bridgewater Associates

US central bank officials are also concerned about the deteriorating global outlook. The International Monetary Fund last week lowered its forecast for global growth in 2019 to 3 per cent, the lowest rate since the financial crisis.

The Washington-based fund also warned that companies had responded to ultra-low interest rates and plentiful liquidity by taking on levels of debt that risked becoming a $US19 trillion ($27.7 trillion) timebomb in the event of another global recession.

Glum global outlook

In it's half-yearly update on the state of global financial markets, the IMF said almost 40 per cent of the corporate debt in eight leading countries – the US, China, Japan, Germany, Britain, France, Italy and Spain – would be impossible to service from corporate cash flows if there was a downturn half as serious as that of a

decade ago.

The IMF warned that credit spreads in bond markets – the compensation demanded by investors for taking on extra risk – appeared to be too low, given the state of the global economy.

"The search for yield in a prolonged low-interest-rate environment has led to stretched valuations in risky asset markets around the globe, raising the possibility of sharp, sudden adjustments in financial conditions," the IMF report warns.

For his part, Mr Dalio was doubtful a debt crisis was likely in an environment where ultra-low interest rates kept a lid on debt servicing costs.

Still, he noted that while the dynamic which saw companies continuing to pile on debt had almost reached its limits, companies would still be left saddled with large debt burdens.

"So that creates this big sag, more than it's likely to create a big bust," he said.

It's clear investors are becoming more fearful that asset prices could sag, dragged down by the combined weight of large debt burdens and stuttering economic activity.

Investors don't trust inflated IPOs

Although US corporate bond yields remain low, there are growing strains in junk-rated debt compared to higher-quality corporate bonds, as investors worry about the rising risk of defaults should the economy sour.

And investors' increased skittishness is even more evident in the two high profile initial public offerings (IPOs) that have had to be pulled in the past few weeks.

In the US, WeWork's IPO was slated to be one of the biggest share market debuts of the year,

Institutional investors, however, balked at the rich $US47 billion valuation and were alarmed by the cash-burning business model of the office space company.

Increasingly, investors are questioning the sky-high valuations that have been slapped on technology startups, given the tide of capital that has poured into Silicon Valley as venture capitalists have hunted for new founder-led companies

that might replicate the success of Facebook or Amazon.com.

Of course, there are good reasons for investors' increased wariness. Back in May, the ride-sharing company Uber became the biggest Silicon Valley offering in years when it launched with a $US82.4 billion valuation.

But Uber's shares closed last week at $US32.06, down some 30 per cent from the $US45 they were priced at in the IPO.

And investor misgivings over WeWork's valuation have been vindicated by reports the company is now scrambling to put together a rescue deal for the group that could value its equity at $US8 billion or less.

Along with growing cynicism overvaluations, investors have also become nervous about placing too much faith in the ability of startup founders to adapt to the higher corporate governance standards demanded of publicly listed companies.

The cult of the founder was shaken after Uber's co-founder and chief executive Travis Kalanick was forced to resign in the wake of a series of scandals.

And WeWork's co-founder Adam Neumann resigned last month after some of the company's biggest investors lost faith in him following the dramatic collapse of the IPO.

Local investors displayed a similar diffidence when it came to the $3.2 billion float of consumer finance company Latitude Financial.

The deal, which was to have been the biggest IPO to hit the market this year, was abruptly pulled last week as investors balked at what they saw as an excessive valuation being put on the business.

Risk appetite follows growth

Of course, local investors have their own reasons for caution when it comes to private equity-backed floats. They still remember the disappointing performances of department store group Myer, the chicken giant Inghams Group and the retailer Dick Smith, which collapsed three years ago.

There's also no doubt some investors were concerned about the unshakable self-belief of Latitude chief executive Ahmed Fahour, and the generous financial reward he stood to pocket from a successful float.

On top of a potential total annual salary of $4.84 million and shares worth about $28 million – which were purchased using a $17.5 million interest-free loan from the company in addition to his own funds – Mr Fahour was set to earn a bonus of $22.5 million if the company's listing was successful.

It's probable that in a more buoyant, bullish environment, investors would have happily set all such qualms aside. But as global growth wilts, so will investors' appetite to take on risk.

Save Share License article

READ MORE

Private equity | Hedge funds | Investing | IPO | Monetary policy

Karen Maley writes on banking and finance, specialising in financial services, private equity and investment banking. Karen is based in Sydney. *Connect with Karen on Twitter. Email Karen at karen.maley@afr.com.au*

MOST VIEWED IN COMPANIES

1 **What it was really like to take the world's longest flight**

2 **Vocus releases 'proof' NBN is bypassing retailers**

3 **China starts new $10b Oakajee iron ore push**

4 **AfterPay denies being a sitting duck for regulators**

5 **Precise locations of 7 Western Sydney Metro stations revealed**

LATEST STORIES

Radio

Macquarie Media boss exits ahead of Nine acquisition

28 mins ago

Opinion China

The political art of business in China

37 mins ago

Exclusive Defence

A $3.7b typo nearly sinks submarine project's credibility

1 hr ago

Australian economy

Australia loses 124,000 millionaires due to dollar, property prices

1 hr ago

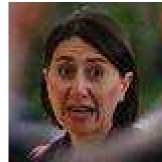
SPONSORED

RECOMMENDED

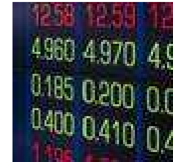
Design's influence on luxury

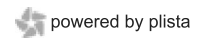
Lessons from ASIC factsheet on SMSFs

Precise locations of 7 Western Sydney Metro stations...



ASX survives tech wreck to end with small gain

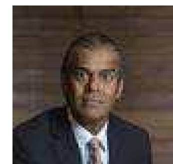




PROMOTED

Lowe, Frydenberg are wrong: rates to be cut again

No place for unelected central bankers



A view from the street as Hong Kong descends further into...

Why bonds still matter in a low interest world

TDM's Corlett prepared to 'roll sleeves up' in growth hunt

LHC Capital stands by suspended iSignthis

THE AUSTRALIAN Financial Review Magazine

From funk-punk to furniture: How design adopted Tom Dixon

Light touch helps aviator's ambitions take off

Celebration of the seasons in a culinary theatre

Adam Scott glimpses future through the business of golf

How woodworking helps this hedge fund manager

BOSS

We're ready to boom, says Incitec Pivot's Jeanne Johns

Company directors wrestle with competing demands

Why this CEO refuses to get up at dawn

Company boards need directors with entrepreneurial flair

A third of boards say CEOs are too optimistic

Life & Leisure

How Nick Cave's wife captured hearts and minds with needle and thread

Exec's top pick for a breath of fresh air

Sanjeev Gupta buys Potts Point trophy home

We road-test the long-awaited, all-electric Porsche Taycan

Why the first all-electric Porsche is not an SUV

Special Reports

Five signs you may be living with anxiety

The brands driving a sustainable future

Generating yield in a low interest rate environment

Start-ups offer enormous rewards but skill and patience required

Property investors thinking beyond the home

My Premium AFR

Subscription Terms

Contact & Feedback

Markets Data

Brands

Our Network

© Copyright 2019 The Australian Financial Review

Reprints & Permissions

Privacy Policy

Terms & Conditions Of Use