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Don't get caught up in the next bubble

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South Florida investors hoping to catch the "next big thing" on its way up should beware of the bubble effect. After the rise and fall of the dot-coms in the 1990s and the "condo-mania" real estate crash a decade later, investors should know that speculative investments are like the witches brew in Macbeth -- nothing but "bubble, bubble, toil and trouble."

Hopefully, investors have learned the right lessons from these recent investment bubbles. First, when investors rush to buy an asset, the price quickly becomes artificially inflated. Second, a sudden boom in an asset's value is often followed by an equally sharp collapse and third, investors must diversify their assets to guard against being caught in the next bubble.

For one thing in the investment world remains certain: another bubble will appear in the not-so-distant future. As the U.S. and global economies turn upward, and the financial markets rebound, investors will search for assets that promise above average returns.

After all, greed, along with fear, is one of the fundamental emotions that drive investors. And after some investors found themselves losing a significant percentage of their net worth in the past two years, they will be tempted to recover their losses by shifting their assets into volatile, higher-risk categories.

So, how can investors avoid being caught up in the next bubble?

First, an investor should be able to recognize the early warning signs of a bubble, such as a sudden jump in trading volume or value without an underlying reason for the change. Next, financial commentators notice the trend, which rapidly becomes a hot topic in the news media and in social conversations. Financial criminals and charlatans take advantage of the bubble mania to prey on investors' greed, and any calls for caution are swept away by a wave of "irrational exuberance," in the words of former Federal Reserve chairman Alan Greenspan.

It's a boom-and-bust cycle that dates back at least to the 1600s -- and shows no signs of disappearing in the 21st century.

On the other hand, not all rises in asset values produce speculative bubbles. A change in economic conditions, government regulations, foreign exchange rates or other factors can produce sustainable increases in value. For example, the oil cartel's decisions to increase or decrease the world's petroleum supply affect the prices of oil stocks. Recent growth in the economies of countries like China, India and Brazil produce new opportunities for investors.

Unlike an investment bubble, the fundamental signs remain positive for stocks, particularly those in emerging markets: Price/earnings and price/book ratios are modest and the valuation of equities relative to cash and bonds is low. In recognition of this broad improvement in the global economy, U.S. equities rose by 64 percent from March to November, while global equities returned 77 percent in U.S. dollar equivalents.

On the other hand, some assets, such as commercial real estate, are likely to remain weak for the next year, until there are solid increases in job creation and consumer spending.

To achieve successful results in 2010, South Florida investors will need to look for assets that provide a modest level of positive returns and avoid the bubble mentality.

As savvy real estate investors know, it's best to buy when the party is over and you can pick up assets at a fraction of their peak value.

It's hard to go wrong when you "buy low" and can hold onto an asset until you can "sell high."

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