

The first-order impact is clear. Institutional investors have found it difficult to achieve positive real yields in any of the traditional safe-haven investments. Life insurers, for example, have struggled to meet their guaranteed rates of return. According to a [recent report](#) by Swiss Re, had government bonds been trading closer to their “fair value,” insurers in America and Europe would have earned some \$40-\$80 billion from 2008 to 2013 (assuming a typical 50-60% allocation to fixed income). For public pension funds, an additional 1% yield during this period would have increased annual income by \$40-50 billion.

Investors have responded to near-zero interest rates with unprecedented adjustments in the way they allocate assets. In most cases, they have [taken on more risk](#). For starters, they have moved into riskier credit instruments, resulting in a compression of corporate-bond spreads. Once returns on commercial paper had been driven to all-time lows, investors continued to push into equities. Approximately 63% of global institutional investors increased allocations in developed-market equities in the six months prior to April 2015, according to data from a recent [State Street survey](#) – even though some 60% of them expect a market correction of 10-20%.

Even the world’s most conservative investors have taken on unprecedented risk. Japan’s public pension funds, which include the world’s largest, have dumped local bonds at record rates. In addition to boosting investments in foreign stocks and bonds, they have now raised their holdings of domestic stocks for the fifth consecutive quarter.

These allocation decisions are understandable, given the paltry yields available in fixed-income investments, but the resulting second-order impact could ultimately prove devastating.

The equity bull market is now six years old. Even after the market volatility following the crisis in Greece and the Chinese stock market’s plunge, valuations appear to be

high. The S&P 500 has surpassed pre-2008 levels, with companies' shares trading at 18 times their earnings.

As long as the tailwinds of global quantitative easing, cheap oil, and further institutional inflows keep blowing, equities could continue to rally. But at some point, a real market correction will arrive. And when it does, pension funds and insurance companies will be more exposed than ever before to volatility in the equity markets.

This overexposure comes at a time when demographic trends are working against pension funds. In Germany, for example, where 20% of the population is older than 65, the number of working-age adults will shrink from about 50 million today to as few as 34 million by 2060. Among emerging markets, rapidly rising life expectancy and plunging fertility are likely to double the share of China's over-60 population by 2050 – adding roughly a half-billion people who require support in their unproductive years.

If the combined effect of steep losses in equity markets and rising dependency ratios cause pension funds to struggle to meet their obligations, it will be up to governments to provide safety nets – if they can. Government debt as a percentage of global GDP has increased at an annual rate of 9.3% since 2007.

In Europe, for example, Greece is not the only country drowning in debt. In 2014, debt levels throughout the eurozone continued to climb, reaching nearly 92% of GDP – the highest since the single currency's introduction in 1999. If pensions and governments both prove unable to provide for the elderly, countries across the continent could experience rising social instability – a broader version of the saga playing out in Greece.

The new Lords of Finance have arguably been successful in many of their objectives since the financial crisis erupted seven years ago. For this, they deserve credit. But, when an emergency strikes, large-scale policy responses always

produce unintended consequences typically sowing the seeds for the next full-blown crisis. Given recent market turmoil, the question now is whether the next crisis has already begun.