Wall Street's bleak week: a warning of things to come?

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The past week's plunge on the New York Stock Exchange has raised widespread fears on Wall Street that the protracted stock market bubble may be about to burst. The week saw three daily drops in the 200-point range, culminating in Friday's 267-point plunge in the Dow Jones average, the biggest in over a year.

The cumulative fall of 630 points in five days was the worst week ever in absolute terms, while the percentage drop of 5.92 percent was the biggest in a decade, since the aftershocks of the October 1987 crash. Friday's sell-off took the Dow Jones below the 10,000 mark briefly, for the first time since last April, before the average rose slightly, ending at 10,019.71. The decline since the market's peak above 11,300 in late August is more than 11 percent.

Two events served to trigger Friday's slide in share prices. On Thursday night Federal Reserve Board Chairman Alan Greenspan, in a speech to a conference on financial risk management, repeated recent warnings that a sudden fall in stock prices could trigger wider financial instability. Then on Friday morning the Commerce Department released figures showing a sharp 1.1 percent jump in the Producer Price Index for September, a barometer of inflation that was viewed as a signal of another increase in interest rates by the Fed at its next meeting in mid-November.

Neither Greenspan's speech nor the PPI report were all that significant in themselves. The price index was skewed by a sharp rise in price for petroleum products, new cars and tobacco products. With these excluded, wholesale prices rose only 0.1 percent.

Nor did Greenspan's speech break new ground. It was devoted to the subject of technical estimates of the risks of various forms of investment, including US Treasury bills, stocks, and corporate and foreign bonds. He repeated the theme which he has sounded in several recent speeches, that the Federal Reserve and other central banks and regulatory agencies are powerless to foresee, let alone prevent, the bursting of a financial bubble. Such a catastrophe is "incontrovertibly evident only in retrospect," he said.

"History tells us that sharp reversals in confidence occur abruptly, most often with little advance notice," Greenspan said. "These reversals can be self-reinforcing processes that can compress sizable adjustments into a very short period. Panic reactions in the market are characterized by dramatic shifts in behavior that are intended to minimize short-term losses." He added that investment managers who relied on sky-high stock prices to bolster balance sheets "could find that they are underestimating the credit risk of individual loans based on the market value of assets."

In the course of his speech Greenspan ruminated about the similarities in behavior of speculators during financial collapses ranging from the Dutch tulip mania of the 1700s to the Russian stock market debacle of August 1998. There is ample reason for the head of the US central bank to be concerned about the irrationality of investors in a capitalist financial panic, since there are increasing signs that the American stock market of the 1990s will produce the greatest of all such panics—in direct proportion to the size of the speculative bubble itself.

One significant fact is the near-silence of the American media during the past weekend on the subject of the market's downward plunge. This is extraordinary, given the recent history of such events—the 1987 collapse, for instance, followed the pattern of a period of extreme volatility, a Friday mini-collapse and then the full-fledged rout of Monday, October 19.

But there was virtually no discussion of the stock

exchange or the US economy in the Sunday interview programs on the TV networks, and little commentary in the major daily newspapers. More than likely, there is a strenuous campaign under way behind the scenes to prevent another "Black Monday," and keeping quiet in the media is part of this concerted effort.

The slide in the Dow Jones index since August has brought the averages—which are only a distorted measure of overall financial conditions—into line with the performance of the broader market, in what some analysts have called "a stealth bear market."

Even with the recent slump, the Dow Jones Industrial Average is up 9 percent for the year and the Nasdaq up 25 percent. But the Dow is an average of only 30 stocks, while the Nasdaq's rise is powered by less than a dozen high-tech stocks, including such firms as Microsoft, Amazon.com and Yahoo!.

The 500-stock Standard & Poor index is up only 1.5 percent for the year, but only seven stocks account for most of the increase. Decliners lead gainers 284 to 216 for the year, with 136 stocks down more than 25 percent and 68 stocks down more than 30 percent.

An even broader measure, the Wilshire 5000 index, shows a 1.8 percent decline for stock values taken as a whole, since January 1. Some 290 Internet-related stocks, with 7 percent of total market capitalization, were up over 51 percent for the year, demonstrating the gulf between the Internet frenzy and the overall decline in the majority of stocks.

This disparity has been commented on frequently in the financial press, where a mood of expectation has set in, anticipating the day when the collapse of the Internet bubble reveals the deteriorating position in the rest of the market. That day now appears imminent.

The year-long binge in Internet stocks has been fueled by an influx of capital into the stock market which is unsustainable. According to one financial survey, cash holdings of American households are at a record low, only 3.59 percent of total financial assets, down sharply from 3.96 percent in the third quarter of 1998, when the latest stock surge began.

Borrowing to buy stocks has played an increasingly important role in fueling stock prices, nearly doubling from $78.6 billion in 1995 to a record $155 billion this year. Such borrowing, which generally uses the value of the stocks as collateral, frequently comes at ruinous interest rates. (Typical among small-scale speculators is to obtain a home equity loan, frequently at double-digit interest rates, and invest the funds in the handful of "star" stocks, such as Microsoft, AOL.com and Merck. Any significant fall in stock prices would place thousands of such investors in danger of losing their homes.)

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