What's behind the split in stockmarket values

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Global stockmarkets have been increasingly characterised by something akin to a “split personality” syndrome in recent months. While stocks in what is described as the “old economy” have been in steady decline for the past year and more, shares in the so-called “new economy” based on technology and the Internet continue to rise.

The increasing bifurcation in the market has been the subject of discussion by market analysts for some months, but has only recently become the subject of more general comment.

Last Friday, the Dow Jones index closed at below 10,000 for the first time since April 1999, representing a 16 percent decline on its all-time high reached in January. However the Nasdaq index, which is dominated by technology stocks, finished the week 4 percent up, after posting its largest ever one day point rise along the way.

Commenting on the split in the markets, *The Economist* magazine noted: “So precipitate has been the rush out of ‘old economy' shares and into ‘new economy' ones that there are now, in effect, two different equity markets. In one, for most technology stocks, share prices are still rising; in the other, for all other shares, there is almost a bear market.”

While the Dow Jones has either stagnated or fallen back, the Nasdaq index has almost doubled in value since last August, increasing by 12 percent this year. But the divergence is not fully revealed even by these figures for as *The Economist* went on to point out the increases in the broad market indices have been sustained by “a mere handful of shares”.

“Last year, according to Morgan Stanley, a 21 percent rise in the S&P 500 was propelled by a mere 31 shares. In 1998, when the S&P rose by a similar amount, its growth was delivered by 89 companies; and in 1996, a similar rise came from 216. Three-quarters of shares listed on the NYSE are trading below their 200-day moving average price.”

On the New York Stock Exchange 75 percent of stocks have dropped 20 percent or more from their 1998-99 highs and around 43 percent have dropped by more than 40 percent.

There are a number of factors contributing to the bifurcation in the market. First and foremost is the speculation in technology and Internet stocks, which has assumed a spiral-like character. New money flowing into the market is directed to the technology stocks experiencing the biggest price rises, pushing their values up even further and so attracting further new money as well as drawing investment away from “old economy” stocks.

This is not only an American phenomenon but has been reflected in stockmarkets around the world. For example the communications company Nokia accounts for almost two-thirds of the Finnish share market's total value, while Ericsson is 44 percent of the Swedish sharemarket, and in London Vodafone/Mannesmann accounts for about 15 percent of the FTSE index.

In Japan, while major engineering, shipbuilding and manufacturing firms have been experiencing worsening conditions, there has been something of a boom in technology-based industries. While traditional employers are laying off workers, output in the information technology sector of the economy is growing at an annual rate of 12 percent and productivity is rising by 7 percent per year. Foreign investors have moved in to buy technology-based shares while the shares of many traditional companies are at 25-year lows.

Recent Australian experience underscores the problems caused for major corporations by the divergence in sharemarkets. Announcing a plan earlier this week to slash costs, cut debt and aim for a 12 percent return on shareholders' funds (compared to the present return of just 3.5 percent) BHP chief executive

Paul Anderson bemoaned the shift in valuations, which has seen more than $9 billion wiped off the company's market capitalisation in recent months.

Anderson claimed the stock, which until very recently was referred to as the “market leader”, had fallen out of favour because of the rush into technology and Internet-related stocks.

While speculation in “new economy” stocks is certainly a major factor in the market divergence, there are also more fundamental processes at work.

The decline in the “old economy” stocks and the emergence of a “stealth bear market” can be traced back to mid-1998 when the so-called Asian financial crisis spread through world financial markets.

The Asian crisis itself was the expression of recessionary tendencies in the global economy, reflected in the over-capacity and stagnant profit rates in major manufacturing industries. Those conditions have not changed over the past two years. In some respects they have worsened as major industrial corporations face increased downward pressure on selling prices for their goods and fierce competition.

Under such conditions, the road to increased, or even stable, profits is relentless cost-cutting. One way in which firms are looking to reduce costs still further—after the downsizing of the past decade—is the reorganisation of internal structures through the use of the Internet. This is where the “old” and “new” economies intersect.

By using the Internet, corporations are looking to more closely integrate their operations with both suppliers and customers, thereby reducing costs and acquiring cheaper supplies and parts, enabling them to boost profits under conditions where selling prices for their products are stagnant or even declining.

Significantly the largest rise in technology stock values in the recent period have been in the so-called B2B (business to business) firms, which are involved in Internet applications for business organisations, rather than selling products to final consumers.

In other words, the divergence in stock market value far from expressing the emergence of a “new” technology-based economy immune from the effect of interest-rate rises and fluctuations in the business cycle, in contrast to the “old economy”, is a further indication of the crisis of profitability and overcapacity which dominates the world capitalist economy as a whole.