Sell-off of high-tech stocks reveals fragility of US financial boom

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13 April 2000

The current sell-off of high-tech stocks is the latest sign of the underlying instability and fragility of the speculative bubble on Wall Street. The US stock markets are now experiencing levels of volatility not seen since the 1930s.

The present crisis is centered on the Nasdaq Composite Index, which doubled in value over the last year due to huge price rises in Internet and other so-called New Economy stocks. Over the last three days the Nasdaq has fallen nearly 700 points, slipping well below the 4,000 point mark. Since reaching a record high of 5048 points on March 10, the index has lost 20 percent of its market value.

The sharp decline began last week when the Nasdaq fell 349 points, or 7.6 percent of its market value, on April 3, the largest one-day point fall in its 21-year history. While the sell-off appeared to be triggered by the imminent, but widely expected, anti-trust ruling against Microsoft, the software giant's 8.5 percent drop only accounted for a sixth of the decline. Of the stocks in the Nasdaq 100—generally the largest companies in the composite index—86 fell in value, reflecting a far broader crisis.

This fall-off turned into a rout by early Tuesday afternoon, April 4, with the Nasdaq plunging another 575 points, or 14 percent. At the same time, the blue-chip Dow Jones Industrial Average, which had benefited from the rush of investors from the Nasdaq recently, also fell over 500 points, or 4.5 percent. Major companies like American Express and General Electric saw sharp declines.

By early afternoon, $1.2 trillion in value had been erased from the markets, the biggest one-day sell-off in history. If the previous day's losses were added, the figure was closer to $2 trillion.

By lunchtime panic had set in at on-line day-trading companies, mutual funds and hedge fund offices and brokerage firms. Anxious sellers were unable to find any buyers and there appeared to be no floor for the price of stocks that until recently had seen 2,000 and 3,000 percent increases in paper value. The *Wall Street Journal* described the solemn mood at the usually raucous Manhattan office of one day-trading firm Generic Trading. The firm's president, Ron Shear, the newspaper said, went into an office, shut the door and yelled to another executive, “The game's over.”

As stock prices fell the sell-off was accelerated by a record number of margin calls from brokerage houses demanding additional deposits from customers who purchased stocks on credit. In many cases individual investors and hedge funds—which are only required to put down in cash 50 percent of a stock's value to buy it—did not have any more money to meet the margin calls. This forced investors to sell off whatever stocks they could. With few buyers of Nasdaq stocks, the sell-off drove down prices on the New York Stock Exchange and other markets.

By 1:18 Tuesday afternoon the frantic selling reached its peak. Then just as spectacularly as the market plunged, it reversed itself, and momentum quickly built up in the other direction. In just a little over an hour, the Nasdaq recovered 452 points, or 10.7 of the 13.6 percentage points it had lost. By the closing of the trading day, the Nasdaq finished down 75 points, after regaining $855 billion in market value. The total swing on the Nasdaq, from top to bottom, was an unprecedented 1,074 points, or 25.4 percent.

The Dow Jones also recovered. In less than a half hour it rose 365 points and then ended the day 57 percentage points down—a swing of nearly 900 points. The broader Wilshire 5,000 index, which includes about 7,200 companies, or nearly every publicly traded company with headquarters in the US, ended up with a loss of about $190 billion, having recovered about $1 trillion in market value in less than three hours.

The rapid buyback of stocks pushed trading volume into record levels. By the end of the day nearly 2.8 billion shares were traded on Nasdaq, surpassing the record 2.19 billion on March 1. Over 1.5 billion shares were traded on the New York Stock Exchange, exceeding the previous record of 1.48 billion, made on March 16.

There is good reason to believe that neither the sell-off nor the recovery were simply the result of the blind operations of the market. It appears that major investment institutions, analysts and other Wall Street movers orchestrated the sell-off to drive down the value of vastly over-inflated Internet stocks, wipe out mid-size and smaller investors, and redirect cash flow to the more established and profitable technology companies, as well as traditional Old Economy stocks.

According to published reports big investors, including market “specialists” with huge sums of capital at their disposal, made a concerted effort in the afternoon to stabilize share prices. Hundreds of billions of dollars were poured into the market and bids in the 25,000 share range were made for major technology stocks, such as Cisco Systems, Oracle and Intel, as well as blue chips such as General Electric, Procter & Gamble and Coca-Cola, helping to turn the market around, traders said.

The *Wall Street Journal* reported that portfolio managers at the mutual fund company Janus Capital, which manages $310 billion, began to issue new buy orders for recommended stocks that were down as much as 15 or 20 percent on the day. Rob Cohen, co-head of listed trading at Credit Suisse First Boston, said, “When people saw the ridiculous levels that stocks had traded to intraday, that generated some real buying interest. We saw some real institutional buyers coming into the market then.”

At the same time major Wall Street investment firms, such as Morgan Stanley, Paine Webber and Merrill Lynch, which until recently had recommended buying Internet stocks on every dip in the market, remained silent as prices for these stocks nose-dived. Instead their analysts reaffirmed the position that many of the Internet stocks were vastly overvalued and in need of a correction.

After the sell-off the chief market analyst from Paine Webber said such stocks had been “trading on psychology” and added that the 20 most popular technology stocks with no earnings would have to go down another 40 percent before he would recommend them for purchase. This was echoed a few days later by the chief market analyst at Merrill Lynch who called on investors to reduce their “exposure” to these stocks and “increase commitments to the energy, basic industry, consumer-cyclical and financial sectors of the market."

In his comments at a White House conference on the New Economy April 5, Federal Reserve Chairman Alan Greenspan raised the issue of using monetary policy to "restore balance in financial and product markets." While, he said, it was not appropriate at this time to do so, he added, "history will judge" whether the expectation of sharply higher profits for technology companies that had driven the gains in their share prices was "prescience" or "wishful thinking."

Nearly 90 percent of stocks in the Nasdaq composite are down 20 percent or more from their 52-week peaks, according to Salomon Smith Barney. Internet start up companies, with names like Internet Capital Group and PurchasePro.com, whose values shot up between 1000 and 3000 percent in 1999, have seen their share prices fall 50 percent or more in recent weeks. One previously high-flying company, EToys, Inc., is down to $7.56 a share, from $86 in October. Even the long sought after Amazon.com is around $69 a share, from a 52-week high of $112. With projections of further e-commerce losses, the influx of money from investment bankers, venture-capitalists and initial-public-offerings is apparently drying up.

In the last few weeks there have been increasingly frequent comments by bankers, analysts and newspaper columnists expressing concern about the huge run up in Internet stocks over the last year. They have pointed to the massive valuations of companies that have never generated a profit, and warned that hundreds of billions of dollars are being drained away from more financially-sound and so-called Old Economy businesses, threatening to destabilize the US financial system as a whole.

In the last year alone, half of the $113 billion investors have put into mutual funds have gone into those that specialize in technology stocks and higher-risk shares. In the last month alone, the nation's biggest single index fund, the Vanguard 500 Index Fund, which tracks the large-company Standard & Poor's 500-stock index, saw $740 million pulled out by investors who jumped to tech-specialty and other so-called aggressive-growth mutual funds. One hedge fund manager, who was forced to shut down after suffering heavy losses, blamed "an irrational market, where earnings and price considerations take a back seat to mouse clicks and momentum."

These critics have pointed out that momentum buying, ie., buying stocks because their share values are rising, also encourages outright fraud by the owners of Internet start-ups seeking further investment.

Wall Street investors value Internet companies not according to their profits—because most have none—but by sales revenues. A hot New Economy company can trade at 200 times its revenues, while an industrial firm making actual products trades at around 15 times its profits. This puts enormous pressure on Internet CEOs to make their revenue numbers look bigger than they actually are.

A *Washington Post* columnist recently pointed to this trend in an article entitled, "Bubblenomics," printed in the newspaper on Sunday April 2, the day before the Nasdaq's initial sell-off last week. In it David Ignatius writes: "The US economy has been like a frontier town the past few years—with so much quick money to be made in dot.com city that folks inevitably began to ignore the rules and disrespect the town elders."

Fortune magazine recently wrote an article about accounting gimmicks used by a number of dot.com companies to inflate their earnings figures. In one example it profiled Priceline.com, the highly valued web site that lets consumers bid for everything from airline tickets, to hotel rooms, to supermarket items. Priceline had reported $152 million in revenue in its most recent quarterly Security & Exchange Commission filing—even though that was the total "gross bookings" customers paid for tickets and other services. After paying the companies that actually supplied all the goods and services, Priceline's revenues (which it calls "gross profit") were just $18 million. And after paying all its other costs, Priceline reported a net loss for the quarter of $102 million. "Priceline" *Fortune* noted, "currently trades at about 23 times its reported revenues, but at a mind-boggling 214 times its `gross profit.'"

Another common accounting trick, Ignatius points out, involves treating barter deals between Internet companies as if they were real money coming into a business. "Let's say that davidignatius.com can't sell any of its space to advertisers, but it convinces other web sites to trade space, for free. Some dot.coms actually treat these barter deals as real revenue. Fortune noted that 26 percent of revenues in last year's third quarter by StarMedia Network, a Latin American portal, was actually barter—ie., no cash. Third-quarter revenues of other prominent dot.coms were similarly inflated by barter deals, Fortune noted—including 21 percent of VerticalNet's revenue, 20 percent of WebStakes's and 18 percent of SportsLine's."

Welcoming the recent decline on the Nasdaq, Ignatius concludes, "There are glimmers of hope that the Wild West days may be ending and that the financial sheriffs are restoring order in Dodge City."

It appears this is exactly what the major players on Wall Street did, without the slightest regard for the thousands of small investors they wiped out, or the impact on the retirement savings of millions of working people tied up in the markets.

The only concern expressed in these circles is that the effort to drive down high-tech stocks may have the unwanted result of bringing down the whole structure. John Manley, senior equity strategist at Salomon Smith Barney, said, "We had a 20 percent correction, and I hate to say it, but that comes with the territory. We worried that there wasn't enough fear in the market. Well, be careful what you ask for, you might just get it."

The current volatility on Wall Street is symptomatic of the fragility of the US economic and financial system. Although the Clinton administration and the American media never tire of proclaiming that the US is enjoying a record economic expansion, there are many signs that not all is well: each month new announcements of record US trade deficits are made; corporations continue to face low profit margins and deflationary pressures persist. This, in turn, has helped fuel the drive for quick profits on the stock market.

The speculative frenzy is hardly a problem of just a few Internet startups. The US economy is characterized by a vast separation between the production of real wealth—which depends on the mental and physical labor of working people—and the creation of trillions of dollars in fictitious capital on the stock markets. But these vast sums of money are claims on the creation of future wealth, and will continue to be the object of a ruthless struggle by competing sections of capital.

Thus while the immediate direction of the market may be unpredictable, it is certain that corporate America will continue its attack on the jobs and living standards of the working class, in the name of "enhancing shareholder value."