Massive speculation fuelled by the Fed has driven Wall Street surge

Nick Beams
7 September 2020

The turbulence on Wall Street at the end of last week, when markets sold off, has revealed at least some of the rampant speculation that has been at the centre of the market surge since its crash in the middle of March.

The main factor in the surge has been the $3 trillion of support provided by the Federal Reserve through its intervention as the backstop for all areas of the financial market, coupled with its commitment to ultra-low interest rates. This policy was guaranteed for the indefinite future last month when the Fed shifted the parameters of its monetary policy by removing the threat to lift interest rates if inflation rose and unemployment fell.

Its interventions have resulted in a rise in market indexes back to their all-time highs reached earlier this year. But this has been concentrated in the biggest US companies by market capitalisation—Apple, Amazon, Alphabet (the owner of Google), Microsoft and Facebook—with a combined value of more than $8 trillion.

According to the *Wall Street Journal* they have been trading at an average of 44 times their expected earnings, a level only exceeded by the 50 times price-to-earnings ratio which occurred during the dot.com bubble at the turn of the century.

There were reminders of the collapse of that bubble last Thursday when the tech-heavy Nasdaq index dropped nearly 5 percent, while the S&P 500 fell 3.5 percent and the Dow was down by more than 800 points or 2.8 percent. There were further, smaller, falls on Friday after the market had moved down sharply earlier in the day but then recovered somewhat in the final hours of trading.

The size of the escalation in tech stocks is indicated by Apple. Last month its market capitalisation reached more than $2 trillion—making it the first company to attain that level —having gained more than $1 trillion in just 21 weeks and $700 million in July alone.

Apple had the biggest loss on Thursday as its shares dropped by 8 percent, causing it to lose almost $180 billion in market capitalisation, the biggest one-day loss for a US company on record. But the extent of its rise is indicated by the fact that this loss was larger than the individual market capitalisation for 470 of the 500 companies listed in the S&P index.

The escalation of the market capitalisation of high-tech companies has given rise to what has been called a K-shaped phenomenon—the movement of a narrow group of companies away from the rest of the market.

This shift was underscored last week when the oil and energy giant ExxonMobil was removed from the list of 30 major companies that make up the Dow Jones index. It was the company with the longest tenure in the Dow, entering it in 1928, and as recently as 2011 was the largest company by market capitalisation in the world.

One of the key factors in the high-tech surge in August has been the use of financial derivatives, most notably call options. A call option is the right to buy a share at an agreed price at some point in the future. The purchaser is then able to make a gain if the share price rises above the contract level.

According to reports in the *Financial Times* and the *Wall Street Journal* last week, the Japanese financial conglomerate SoftBank has been a major buyer of call options in high-tech companies.

Under normal conditions, call options are to some degree balanced by put options, a contract to sell a share at an agreed price as investors seek to hedge themselves against potential falls in the market.

But as the *Financial Times* noted in the past few months "this has been flipped on its head for mega-cap stocks and there has been rampant buying of call options—particularly on Apple and Tesla" as investors have weighed in with bets that the market will keep on rising.

At present Softbank is reported to be sitting on trading gains so far of around $4 billion. The speculation goes beyond Softbank. According to Goldman Sachs, the overall nominal value of call options on individual US stocks reached a record high in the past two weeks, averaging $355 billion per day, triple the daily average between 2017 and 2019.

Corporate executives appear to be less confident. According to data compiled for the *Financial Times* some 1,042 US chief executives, chief financial officers and company directors sold $6.7 billion worth of stock in August, the highest level for any month since November 2015.

The accumulation of wealth in the hands of the financial elites is taking place as the conditions for the working class continually worsen as even the limited relief earlier provided is cut off or significantly reduced. The jobs report issued last week has been seized on to continue that policy.

The Department of Labor said employment rose by 1.4 million in August, a figure that was hailed as showing that the economy was on the improve, as Trump's economic adviser Larry Kudlow virtually ruled out any move to provide further assistance. "Right now the economy is on a self-sustaining recovery path in my judgement and will continue along these lines, and will continue to surprise on the upside," he said.

The data in the report belie this assessment. There are still 11.5 million fewer jobs than there were in February and the rate of employment growth is slowing. In June employment grew by 4.7 million, falling to 1.7 million in July before dropping further to 1.4 million last month.

Moreover, many of these jobs are part-time or casual as companies cut back on the full-time workforce. The employment numbers for August were also boosted by the hiring of 238,000 temporary census data workers who will soon be laid off.

The data for August also showed that the number of workers who have been permanently axed, as opposed to being temporarily laid off, is on the increase, rising from 2.9 million in July to 3.4 million in August. A report cited in the *Washington Post* noted that 20 percent of the permanent sackings in May and June had been characterised as temporary a month earlier.

And this trend will continue. As the *Wall Street Journal* reported last month, a recent study found that "nearly half of US employers that furloughed or laid off staff because of COVID-19 are considering additional workplace cuts in the next 12 months."

This indicates that the pandemic is being used to carry out "restructuring" operations to boost the bottom line, in combination with measures that have resulted in 10 million private sector workers either having their pay cut or being forced to work part time.

Workers employed in small businesses have been especially hard hit, with one study finding that 50 percent of them furloughed since March have still not been able to find work. The number unemployed for 15-26 weeks is now nearly double what it was in the recession of 2009.

While the billionaires continue to rake in money through speculation, with the potential to set off a financial crash as the downdraft on Wall Street at the end of last week showed, the situation in the real economy is worsening.

According to Deutsche Bank, zombie companies—those that do not earn enough to cover their interest payments—now comprise nearly one-fifth of all listed companies in the US, compared to virtually zero at the start of the century.