Warning that Wall Street bubble may burst

Nick Beams
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The Wall Street surge, which last year saw hundreds of billions of dollars poured into the coffers of the financial oligarchy making Tesla chief Elon Musk the world's richest man, has continued into the new year. So far this month the Dow has hit a record high three times.

Not even the events of January 6, when fascist forces at the urging of President Trump stormed the Capitol building in the attempt to carry out a coup, could halt its rise.

Amid the rising death and infection toll from the COVID-19 pandemic, the chief reason for the market surge, since the market plunged in mid-March, is the knowledge that any serious downturn will see the Fed intervene with billions of dollars to prop it up. The Fed is already pumping in $120 billion a month—more than $1.4 trillion a year—and has pledged to keep interest rates at near-zero for the indefinite future.

A new factor has now entered into market calculations. It is anticipated that a Biden administration, assuming it takes office, will provide a further boost with increased stimulus packages to aid the corporations.

The nomination of former Fed chief Janet Yellen as Treasury secretary, regarded as a friend of Wall Street in her time at the central bank and the recipient of more than $7 million in speaking fees from major financial firms in 2018 and 2019, has been another boost for markets.

But concerns are starting to be voiced that the orgy of speculation, literally feeding off the death and destruction of the pandemic because of the actions of the Fed, could end in a major crash.

There has been commentary in the financial media over the warnings issued by Jeremy Grantham, head of the investment firm GMO, that the speculative bubble could be about to burst.

In a comment posted on January 5, he wrote: "The long bull market since 2009 has finally matured into a fully-fledged epic bubble. Featuring extreme over-valuation, explosive price increases, frenzied issuance, and hysterically speculative investment behaviour, I believe this event will be regarded as one of the great bubbles of financial history, right along with the South Sea bubble, 1929 and 2000."

Grantham pointed to a number of indicators in support of his warning. He noted that one of the features of the last stages of all previous bubbles was "really crazy behaviour." In the first 10 years of the latest bull-run "we lacked such wild speculation" but "now we have it in record amounts."

Another indicator is the record number of initial public offerings (IPOs) this year as start-up companies seek to jump on the stock market escalator by going public. In 2020 there were 480 IPOs, compared to 406 in 2019. One of the most significant features was that 249 of these were special purpose acquisition companies (SPACs). These are shell companies set up to take over another company that is looking to come onto the share market, enabling it to bypass the usual, sometimes lengthy procedures involved in a traditional IPO.

An even better measure of "speculative intensity" than the prevalence of SPACs, he wrote, was the character of the present bull market, which made it totally different from any previous bubble that all took place when the underlying economy appeared to be enjoying rapid growth.

The present-day "wounded economy" was "only partly recovered, possibly facing a double-dip, probably facing a slowdown, and certainly facing a very high degree of uncertainty."

While the price-earnings ratio in the stock market is in the top few percent of the historical range, he noted, the economy is in the worst few percent. "This time, more than in any previous bubble, investors are relying on accommodative monetary conditions and zero real [interest] rates extrapolated indefinitely."

While the markets have received a boost from the prospect of increased spending from a Biden administration, this is something of a two-edged sword. Increased government spending means an increased issuance of government bonds thereby tending to bring about a fall in their price and a rise in their yield or interest rate.

There are signs of this phenomenon with the interest rate on the 10-year US Treasury bond rising to above 1 percent for the first time in months.

This is being hailed in some quarters as evidence that investors expect there will be a revival of economic growth and profits. That might have been the case in days gone by when financial markets bore some relation to the underlying real economy. But this is not the case now, because corporate profit is increasingly dependent on the maintenance of ultra-low interest rates to prevent a rise in their debt burden and to finance their increasingly speculative operations such as share buybacks.

If the yield on 10-year Treasuries continues to rise, pushing up the cost of money throughout the economy, the Fed will move to intervene with further bond purchases, lifting their price, and keeping interest rates down. It has already been discussing so-called yield curve targeting in which it intervenes to keep the interest on selected bonds within a target range.

The massive increase in debt, both corporate and government, has meant that financial markets are extremely sensitive to even small rises in interest rates. According to one estimate, a 1 percentage point rise in interest rates today would have the same impact as a 3 to 4 percentage point rise of 20 years ago.

The only way that further money can be handed out to the corporations, without provoking an interest rate rise, is for the Fed to buy up the new government debt as it is issued—a further stateisation of the economy and the financial system for the benefit of speculators and the super-rich.

The present situation is the outcome of long-term trends in the US economy. As the editor of the *Financial Times*, Rana Foroohar, noted in a recent comment: "Low interest rates have encouraged a massive flood of debt, little of which is productive. Since 1980, total US debt rose from 142 percent of gross domestic product to 254 percent in 2019."

She cited research by economist Atif Mifan who noted that, if all this additional credit had been used for productive purposes, "we should have seen an explosion of investment. Instead, the investment share of national output *declined* from an average of 24 percent during the 1980s to 21 percent during the 2010s."

This signifies that an increasing amount of debt has been used for speculative purposes such as share buybacks, once regarded as rigging the market but now standard practice for major banks and corporations, as well as the financing of mergers and acquisitions.

Mifan also noted that the rise in finance despite stagnation could "only be understood in light of arguably the most important 'structural break' in American society: the rising share of income going to the top 1 percent."

That is, the financial house of cards is the outcome of the institutionalisation of financial mechanisms through which increasing amounts of the wealth of society are transferred to its upper echelons.

Herein lie the objective roots of the fascist coup attempt launched by Trump and the Republican party. As the WSWS perspective of January 7 explained: "Above all, workers must understand that the disintegration of American democracy is rooted in the crisis of capitalism. In a society riven by staggering levels of social inequality, it is impossible to preserve democracy."

Democracy can therefore only be maintained through the mobilisation of the working class on the basis of a socialist program as the only antidote to the growing fascist threat.