Markets bounce back after Omicron shock as governments decide to let it rip

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After receiving assurances from governments around the world that they would continue their policies of “let it rip,” Wall Street and global markets bounced back from their significant losses on Friday when the news broke of the Omicron variant of the coronavirus and the significant dangers it poses.

In an editorial published on Friday evening, after a sharp fall on the stock market. the *Wall Street Journal*, speaking on behalf of US and global finance capital, laid down the law.

It said the market selloff was driven by the fear of new government lockdowns and social distancing and demanded this not take place.

“One clear lesson from the pandemic is that lockdowns do more harm than good,” it declared, adding, without any evidence, that booster shots would “help the US and Europe weather a winter surge and mitigate the impact of Omicron.”

“Americans and the rest of the world need to learn to live with an ever-mutating virus. So do our politicians,” it insisted.

Politicians around the world, all of whom, whatever their colouration, serve the interests of finance capital, duly took note of their master’s voice. They declared there would be no significant changes in their policies, apart from some token restrictions, largely on international travel.

Consequently, on Monday, after an initial fall in Asian markets, global markets began to rise after the sharp selloff on Friday. On Wall Street the S&P 500 rose by 1.3 percent, the NASDAQ was up by 1.9 percent and the Dow gained 236 points, or 0.7 percent.

Notwithstanding the rebound, Friday’s sharp fall again underscored the fragility of the entire financial system and its dependence on the flow of cheap money from the world’s central banks.

On Friday, the FTSE All World Index dropped by 2.2 percent, its biggest decline since October 2020, as markets in Europe and the US were hit by a wave of selling.

The rapid fall in the market again focused attention on the extent to which the speculative share market boom during the pandemic has been financed by debt, in particular the use of so-called margin debt where investors use shares and other financial assets as collateral for increasing borrowings to finance further risky bets.

A *Wall Street Journal* article noted that Friday’s reversal “underscores the fragility of the rebound from the March 2020 lows, which ranks as the fastest return to record highs following a decline of at least 20 percent from a previous peak.”

According to data from the Financial Industry Regulatory Authority, margin borrowings in October were up 42 percent from a year earlier at $935.9 billion. Cash holdings, which may be called on by the lender if the value of the asset used as collateral falls, declined to 46 percent of margin balances.

These figures do not capture the full extent of debt dependence. They do not take account of the borrowing incurred to finance the purchases of options used by investors and financial institutions to make big bets in financial markets.

An article last week on Bloomberg, published before the Omicron shock, pointed to the increased use of debt as even conservative financial institutions pile into the markets using borrowed funds.

It cited the case of Calper, a $495 billion California public employee pension fund, which planned to take on $25 billion of debt to fund financial asset purchases “because it can’t see another way of hitting its long-term return target of 6.8 percent to meet its promised payouts."

In the past, pension funds and life insurance companies have relied on the government bond market as the source of their revenues. But yields on these assets are at historic lows and they are being forced to conduct riskier operations.

Overall, the article noted, margin lending "has grown rapidly this year, breaking new record almost every month." So far this has not produced a crisis because the stocks that form the collateral for the borrowing have also been rising. Even so, the level of margin debt compared to market capitalisation, as measured by the S&P 500, is close to record levels.

However, if the market falls sharply then the lenders, including large banks, make margin calls, requiring their lenders to advance more collateral.

The same process can be seen in buyout deals, also financed by taking on debt. According to the Bloomberg article, the price of more than two-thirds of US buyouts last year was more than 11 times earnings of the companies before interest, tax, depreciation and amortization. In 2007, amid another buyout boom just before the 2008 financial crisis, the figure was only one quarter.

Another Bloomberg article, published at the weekend as the Omicron news hit, focused on a more recent comparison. It pointed out that one of the reasons the first COVID crash in March 2020 was so "brutal" was "the froth that had built up in markets before the virus landed."

While there were differences in the present situation there was a lot that was the same, it said.

"Viewed from the perspective of valuations, the stock market is notably more stretched than it was at the 2020 turning point" with the S&P 500 price-earnings ratio now about 2 points above where it was almost two years ago.

With the focus of all governments on abandoning all public health measures in order to open the economy, the article reported that, according to a survey by the Bank of America, fund managers said COVID-19 was only fifth in their list of tail risks. It came in behind inflation, central bank interest rate hikes, falling Chinese growth and asset bubbles.

But the variant will have an economic impact. In his prepared remarks to be delivered to Congress today, Fed chair Jerome Powell said the rise in COVID-19 cases in the US and the Omicron variant posed "downside risks to employment and economic activity." It increased the risk of supply chain disruptions and could lead to further uncertainty over inflation.

While there is confidence that governments will take no meaningful health measures which could impact on speculative profit making, the entire financial system is haunted by the possibility that the events of March 2020, when markets went into a tailspin, could be repeated.

Last week, in its annual report to Congress, the US Treasury Office of Financial Research (OFR), noted that while the vulnerabilities created by the present debt binge were being moderated by high corporate earnings, risks were looming.

"High debt burdens result in a corporate sector that is more fragile, riskier, and more vulnerable to shocks," it said. "If the current corporate earnings recovery falters or interest rates rise materially, the corporate sector could be prone to a wave of defaults" that could impose "large losses on lenders and investors" and adversely affect economic activity.

The OFR also noted that the underlying structures that led to the March 2020 freeze of the US Treasury market—the basis of the global financial system—remained "unaddressed."