

Warnings of looming systemic financial risk getting louder

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At first, it was just a few outlier remarks, but now there is a stream of warnings that the US stock market and the financial system more broadly is a bubble set to burst with potentially very serious consequences.

There are two central concerns: first, that the explosive growth of private credit, largely unregulated, has led to the loosening of standards and is resembling conditions that preceded the crash of 2008; and second, that the surge on Wall Street is dominated by a handful of high-tech and artificial intelligence-based stocks in a way that recalls the dot-com bubble at the start of the century with potentially greater consequences.

Concerns about the private credit market were voiced this week by the chair of the global Swiss-based bank UBS, Colm Kelleher.

Speaking at a Hong Kong finance and investment conference, he said there was a “looming systemic risk” to global finance because of the way insurance companies were looking around for better ratings on their private credit assets.

According to a report of his remarks in the *Financial Times*, he said, “The insurance industry, especially in the US, was engaging in ‘ratings arbitrage’ akin to what other institutions did with subprime loans before the 2008 financial crisis.”

In the past, the insurance industry might have been the last place one would have considered to be the source of a financial crisis.

Insurance companies were regarded as staid, conservative financial institutions with straightforward business models selling long-term policies and investing in long-term assets to meet their obligations, providing a source of stability for financial markets. Not anymore, as an extensive analysis published last week by the Bank for International Settlements (BIS) made clear.

It said that since the crisis of 2008, the insurance sector had undergone “profound structural changes.” The extended period of ultra-low interest rates on government debt following the crisis meant that the old business model, based on investment in such assets, was no longer viable, and insurance firms had increased their involvement with private equity firms.

And beyond that, the BIS analysis explained, “life insurers have increasingly shifted their investment strategies towards riskier and opaque assets, such as real estate and alternative credit instruments. These assets often lack transparency and liquidity, making them more challenging to value accurately, which poses potential risks to financial stability in the form of drains to liquidity from fire sales that can amplify price movements during periods of economic stress.”

In other words, the book value of these assets is artificially inflated, and this is revealed in conditions of turbulence when the actual market value is revealed. But before that happens, the fiction is maintained by shopping around for agencies that will provide a higher rating.

Kelleher pointed to this phenomenon in his remarks.

“What you’re seeing now is a massive growth in small rating agencies ticking the boxes for compliance of investment,” he said.

The BIS said the smaller agencies, whose numbers have grown rapidly, faced commercial pressure to assign more favorable ratings, and this could “lead to inflated assessments of creditworthiness” and “obscure the true risk of complex assets.”

The role of private credit has come to the fore in the wake of the collapse of the US auto firm First Brands and the subprime auto lender Tricolor, which had complex relationships with private credit, or what is termed non-depository financial institutions (NDFIs).

A series of frauds involving some middle-sized companies in recent weeks is another area of concern. It has caused a market crisis, but, in the words of one analyst cited by the *Wall Street Journal*, it is “sending out ripples in the credit markets” with people starting to ask, “How does this happen?”

A recent note by JP Morgan Chase analysts said that while the First Brands situation was the result of poor management, it also revealed, “more importantly, very poor disclosure in relation to [NFDIs] across the banking system.”

In other words, there is little knowledge about the connections between the major banks and the non-banking credit system. The International Monetary Fund has been calling for greater oversight of this area and repeated it last month, noting that US and European banks are estimated to have \$4.5 trillion of exposure to non-bank financial institutions.

The growing domination of tech stocks on Wall Street as a result of the AI surge is also causing alarm bells to ring.

The significance of tech stocks was demonstrated on October 28. Such is their weight and that of AI-related companies that the S&P 500 closed at a record high—its 36th for the year—even though 397 stocks in the index fell.

An FT article this week provided some significant details of the tech-AI dominance. Eight of the 10 biggest stocks in the S&P 500 are tech stocks, and they account for 36 percent of the entire US market value. Some 60 percent of the gains since the market downturn in April are the result of the rise of these stocks, and they account for 80 percent of the S&P’s income growth in the past year.

The market value of the AI chipmaker Nvidia has hit \$5 trillion and is now greater than the market value of the stock exchanges of Germany, France and the UK combined.

The market weight of the US AI and tech stocks is indicated by the fact that almost one-quarter of the market capitalization of the MSCI All World Index, which comprises more than 2,000 companies from more than 40 countries, results from the eight dominant US groups.

The divorce of US market valuation from the real economy is revealed by the fact that for most of the period since 1970, it has averaged about 85 percent of

the country’s GDP. It has now risen to 225 percent of GDP.

This has significant economic implications because, however much stock prices may rise, they remain fictitious capital. That is, in the final analysis, they do not embody real value, but are a claim on the value in the underlying real economy and, above all, on the surplus value extracted from the working class, the producers of all wealth.

The financial oligarchy, which has enriched itself to a historically unprecedented degree via the Wall Street surge—financed to a great degree by the cheap money provided by the Fed—is acutely conscious of this relationship, as evidenced by the tremors that pass through the market whenever there is a significant upsurge in the class struggle.

This objective relationship is the foundation for the now open alliance between the oligarchy and the fascist Trump regime, as it seeks to establish a presidential dictatorship—endlessly railing against “socialism,” “Marxism,” “communists” and “lunatic leftists”—and is an expression of the fear that sooner or later, the collapse of the inflated Wall Street edifice will have massive economic consequences and place squarely before the working class the necessity for the socialist reorganization of the economy.



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