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Economic & Market Update

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20 Years Later…

In fact, it was 24 years ago that then Federal Reserve Chairman Alan Greenspan referred to investor optimism as "irrational exuberance." A warning that investor psychology was driving stock prices well beyond their fundamental values. However, as we know, investors ignored Greenspan's warning for another 4 years! From 1995 through 2000 around 20 large corporations saw their stock prices increase by roughly 1,000%, with Qualcomm's 2,600% gain leading the way. When the "Dot-com bubble" finally burst, the NASDQ fell 80% with many of the "high flyers", such as Amazon, Cisco and Qualcomm, falling more than 90%. Overall stock investors lost some $5 trillion with major companies like Enron, Global Crossing, Adelphia and WorldCom, as well as hundreds of popular "startups" such as, pets.com, WEBVAN, etoys.com, Napster, AOL, Alta Vista, Ask Jeeves going out of business.

Roll forward 20 years and we are experiencing Deja' vu on steroids, investors have far exceeded their "irrational exuberance" of the "dot-com" era! Over the past 5 years the NASDQ has added roughly $15 trillion of market value, 5 times greater than the economy expanded over the same period. In the late 1990's the "dot-com bubble" was only twice the size of economic growth ($5 tr vs. $2.5 tr.) The NASDQ is comprised of 3,300 companies, roughly 50% of all US public companies, yet is valued at 115% of the whole US economy ($22 tr vs. $19 tr).

Since 2015, just 6 companies account for nearly 40% of the gains in the NASDQ – Apple, Microsoft, Google, Amazon, Facebook and Tesla, collectively their market value has risen by 300% (some $6 tr). Tesla is the smallest of the 6 companies, yet is the most overvalued – the Qualcomm of this era. Tesla has lost over -$5b the past 5 years but has a market value greater than all other auto makers combined! Apple is the largest and most profitable of the group yet hasn't grown earnings in 6 years!!! Meanwhile, Apple's stock has added $1.5 trillion in value over that time. Amazon has seen the greatest increase in market value, up over 800% (also $1.5 trillion), yet only turned profitable in the past 2 years, mainly the result of government contracts for web services. In other words, Amazon's main business is yet to turn a profit! Microsoft, Google and Facebook have steadily grown earnings over the past 5-years, but their stock prices have increased at twice the rate of earnings growth!

So here we are again facing our 3rd "bubble" in 20 years (not forgetting the RE bubble) and, as in the past, they end with defaults, bankruptcy's, stock market corrections and a move to safety like Treasuries! As we pointed out in our last update the banking system was showing signs of stress in the 2nd half of 2019, before any signs of a pandemic…

"There were many signs the economy was faltering 6 months prior to March 2020. Not only was the Federal Reserve forced to slash rates beginning in August of 2019, they were forced to provide unprecedented daily support (bailout) to the overnight lending system between banks."

As the pandemic spread and the economy was shut down, the subsequent "CARES Act" combined with unprecedented support from the Federal Reserve provided relief to a weaking economy. Obviously, the shutdown(s) continue to be costly to many sectors of the economy, however, the "CARES Act 2020 and 2021" have provided relief to many by adding cash and delaying debt payments both personal and business.

Although the circumstances may differ, the basis defaults/bankruptcy's/market correction lies in too much debt. The debt crisis will emerge from commercial real estate (office buildings, retail space, hotels and condo complexes in major cities) and corporate debt. The past 2 recessions have occurred when corporate debt reaches 50% of GDP – we are there, with about $5 trillion rated "junk" (think subprime for corporations). We are well positioned for what is coming.

As always, I value your thoughts!

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