

‘New Economy’ Bubble Bursts; Investors Lose Billions

by Lothar Komp

Stock prices have been plunging for seven months, and no end is in sight. One thing is sure: If the salami-style crash continues, one slice at a time, for another five months at the same rate, then all the New Economy indexes—the Nasdaq, the German “New Market” (Nemax), and all the rest, will not only have broken through all of the “psychological” and “technical” barriers on their downward course, but will also have fallen below “zero.” Sporadic recoveries of stock prices change nothing in the total picture: The myth of the “New Economy” has been shattered, and the dream of quickly-made fortunes has come to an end. Millions of small investors, as well as wheeler-dealer marketeers, are out in the cold.

In Germany, who still remembers the litany of the New Market journals this spring, which all preached that a “Summer rally” would surely take hold? Later, it was supposed to be the Fall rally. Once the German Nemax-50 index of the New Market had retreated from its peak of 9,600 points in March, analysts, market newsletters, and other professionally euphoric snake-oil salesmen saw, with wonderful regularity, very lucrative “buy opportunities,” which, for those people who fell for it, proved to be a particularly effective method to wipe out money. By mid-October, the Nemax-50 was at 4,000 points, a plunge of a handsome 60%. The American Nasdaq Composite Index is down 40% since its peak in March. The Morgan Stanley Internet index of stocks is down 49% from its peak this year.

A Global, Systemic Crisis

What is manifest in the falling Nemax in Germany—and the glitter off the gold of get-rich-quick—is not merely the temporary panic reaction of the smaller, or even larger investors. *It is a side effect of a far more comprehensive and lawful development.* In the following article, John Hoefle provides

graphic documentation of the underlying processes.

The entire world financial system has gone off the tracks, because of the gigantic dislocations which had built up over decades. It has contracted a deadly disease, which cannot be cured by blood-letting on the stock-markets, nor by pep-pills prescribed by central banks. The entirety of the financial, monetary, and economic crisis phenomena which are hitting like a fist now—from the crash of technology stocks to the tailspin of the euro, to the sudden outbreak of price-inflation—are but different expressions of the disease which is running its course.

A well-known German economist, who is among the more knowledgeable about the U.S. economy in Germany, recently emphasized to this publication that the dramatic distortions and imbalances—worldwide, but particularly in the United States—will necessarily end in a financial catastrophe, of which the current events on the stock markets are but a relatively mild foretaste. In view of the explosive increase of the U.S. current account deficit, an unparalleled dynamic of money-creation, and the illusion of the “New Economy” (created simply by statistical manipulation), will surpass all historical precedents in the inevitable catastrophe, including the stock market crash of 1929.

In comparison to the current situation, the U.S. economy in 1929 was relatively healthy and still ran up trade surpluses. The imminent explosion of imbalances, this economist said, surpass his powers of imagination, and offers such a terrifying perspective that he would not dare to think through the consequences in any detail. Who can say what the world will look after the dollar collapses to a quarter of its current value?

The stock markets are, to be sure, the most obvious and visible aspect of a farther-reaching process of collapse. It is necessary to consider closely the dimension of the crash in

technology stocks which has already occurred. Thirteen years ago, in October 1987, stock prices fell by 20%, and that was called a stock market crash. But how are we supposed to describe the 40% plunge of the Nasdaq, or the 60% dive of the New Market in the year 2000? It has to be kept in mind that the Nasdaq is no longer an exotic market for small and medium-sized firms. The highest rated (according to stock value) firms in the whole world are traded there: Intel, Microsoft, and Cisco. And even these stocks have been decimated.

Intel stocks collapsed, since the beginning of September, from \$75 to less than half, \$35, within just five weeks. Microsoft was at \$120 in December 1999, but on Oct. 17, only \$50 remained. One of the symbols of the Internet age, Amazon.com, the world's largest Internet trading firm, swallowed a collapse from December 1999 to mid-October 2000 of \$113 to \$22—a whopping 80%. The stocks of computer producer Apple were still over \$70 at the end of August. After announcing its profits would be lower than forecast at the beginning of September, stocks fell in three days to less than one-third of their previous value, and then dropped to \$13 by the beginning of October. Dell Computer went from \$60 in March to \$22 by mid-October. The shares of software producer Novell, in March still at \$42, are now to be had for \$8. All of these U.S. firms are heavyweights on the stock market. There are countless smaller firms in addition, especially in the Internet sector, whose values have fallen to less than one-tenth of what they were in March 2000. In Germany, millions of smaller investors watched as the price of the “tech stocks” went from 105 euro to 35 euro.

In Asia, all of the large stocks are rapidly approaching the levels they had in the course of the 1997-98 Asia crisis. The Japanese Nikkei-Index fell in mid-October to its lowest level in 19 months. South Korea is similar. In Taiwan, the stock prices have reached their lowest level in 54 months. Southeast Asian currencies are again under massive pressure. On Oct. 18, the Japanese government suddenly decided to postpone the reform of capital gains taxes for an indeterminate time, because otherwise, as the *Financial Times* emphasized, “a new sell-off on the stock market” threatened.

The apparently inexorable fall of the euro also belongs to this picture. As one European banking source said on Oct. 19, the U.S. stock market can only be held together if the euro is slaughtered at the same time.

Bankruptcy

Another symptom of the worldwide financial crisis is the wave of bankruptcies in corporate bonds. The rate of insolvency in high-yield corporate bonds, so-called “junk bonds,” is now as high as it was ten years ago. Out of fear of more defaults, the risk premium demanded by investors is as large as it was following the Russian moratorium and the collapse of the Long Term Capital Management hedge-fund in the Fall of 1998. William Cross, the chief manager of the largest fund in the world specializing in bonds, the Total Return Funds,

recently warned all investors to avoid corporate bonds “at all costs.” Investors should cut a wide berth around all bonds which cannot prove they are state guaranteed. These warnings are probably too late for a number of large banks, as indicated by the continuing reports and rumors about billions in losses by Deutsche Bank, Crédit Suisse, and a number of American investment banks in the “junk bond” business.

U.S. Federal Reserve Chairman Alan Greenspan and Treasury Secretary Larry Summers will do anything conceivable to keep up the facade of stability until the U.S. election on Nov. 7. Greenspan has proven in the past that he will not shrink from opening the money sluices for the banking system. But these strategists have largely already played their trump cards. The Damocles' Sword of a dollar crisis is rapidly descending on the U.S. economy. And all bets are open for the period following Nov. 7.

Commentaries on the Crash

Morten Bjoern Hansen and Ole Bang Nielsen, *Berlingske Tidende*, Oct. 20:

The International Monetary Fund is deeply worried about the decline of the euro, according to sources close to the IMF. “The IMF thinks that the currency markets are massively underrating the strength of the euro. The IMF fears that the heavy fall of the euro vis-à-vis the dollar can harm the stability of the currency markets in the future, sources close to the IMF tell *Berlingske Tidende*.

“The violent capital flight into the U.S., which has sunk the euro, is, to a large extent, tied to the strength of the dollar. The IMF is nervous about the effect when the markets realize that the euro is way too cheap, and that will give a strong and destructive correction of the rates. . . .

“The mood can quickly change to the advantage of the euro. Should that happen, the IMF fears the consequences, the greater the underrating of the euro is. A sharp turn can send the high-flying U.S. economy crashing to the ground, sending shock waves throughout the entire world economy.”

Heather Connon, “The Fear of Red October,” *London Sunday Observer*, Oct. 15:

“With shares already depressed, there couldn't be a crash—or could there? . . . It does not take much to make investors nervous in October—remember 1987 and 1990, not to mention 1929—so the last thing the City [of London] needs is someone drawing parallels between the current markets and some of those big crashes.”

For many investors, the crash has already happened. The U.S. Nasdaq and its British equivalent, the Techmark 1000, have both lost about one-fifth of their value since the beginning of September, and about 40% since their peaks in March.