BOB HOYE

MARCH 16, 2020

Natural Forces Could Overwhelm Control Freaks

Coronavirus commands the news and is blamed for the financial slump. While devastating to those afflicted by the disease it has only been a catalyst in a natural collapse of speculation. A contraction is *always* consequent to the raptures of a great financial bubble. What's more, on five previous examples since 1720, the transition from boom to bust has been methodical. In so many words, if you have seen one shocking reversal you've seen them all.

The point is that in a boom literally everyone gets hyper busy. The stock market is just one sector, and then suddenly everyone is not busy.

And with the financial industry becoming so pervasive, plunging asset prices quickly bring down the economy. Another issue has been aggressive intrusion by the state in private life. The two main promotions have been that central bankers need to "manage" the economy and that bureaucrats can "manage" the temperature of the nearest planet. Both touted as preventing "bad things" from happening.

However, the ploys have been to insidiously transfer wealth and power to the state, which reckless ambition is now ripe for criticism.

Hopefully, the pandemic is brief. Concerns about the SARS threat ran from November 2002 to mid-2003. Unfortunately post-bubble contractions have been lengthy and a distressing contrast to the party of the preceding decade. The "Era of Good Feelings" ended with the 1825 Bubble. Going into the 1873 Bubble was called the "Gilded Age". And then it was the "Roaring Twenties" that abruptly ended in 1929.

As yet, there seems no equivalent description for our fabulous bubble. Perhaps it's because the governing classes have been enraged by the popular uprising. Why would anyone be angered by attempts to restore the blessings of limited government?

However, the best way to look to the future is through financial history. Another post-bubble contraction has started and it could be accompanied by political reform.

On timing, great bubbles have completed in the ninth year after an important peak in commodities. The last such high was in 2011 and the financial markets may have completed a bubble in January 2020. The previous outstanding example was setup with commodities in 1920 and stocks in 1929. On the preceding bubble the dates were 1864 and 1873. Numbers with the first one were 1711 and 1720. You get the pattern.

In early October, our work called for a strong rally into "around January". Included was that many great bull markets had completed in the "Turn of the Year" window. The gold mania climaxed in January 1980, the wild Nikkei Bubble at the end of 1989, and the S&P in January 1973. All were followed by bear markets.

The key to calling the reversal in January was that speculation had become measurably excessive – in the right time window. Then the objective was to watch for the break in momentum, which occurred late in January. This and the yield curve inverting signaled the demise of this bubble. Markets would have turned down without the Wuhan Virus.

On March 8th, the Financial Times headlined ***"US Economy Dangerously Dependent on Wall Street Whims"***. Naturally – the financial industry is huge. Which was the case with all five previous great bubbles. But the reversals have not been a "Wall Street Whim". They have been methodical, with business activity rapidly turning down with each dramatic failure.

Typically, the stock market peaks about 10 to 12 months before the economy. This is why the "Conference Board" includes the S&P as one of ten components in its Leading Economic Index. But when a bubble collapses, the economy turns down virtually immediately.

The bull market that peaked in October 2007 was not quite a classic bubble, but the economy peaked in that fateful December. Close enough. The 1929 Bubble peaked in September and the economy peaked in August. The 1873 Bubble peaked in September and the recession started in that October. Also close enough.

And without a pandemic scare, the typical pattern of contraction started with a sudden collapse of speculation. In stocks, low-grade bonds and industrial commodities. Indeed, in the 1873 Crash the big high-tech stock was Western Union Telegraph and it gave up 36 percent in 7 trading days. In 1929, Radio Corporation of America plunged from 114 in September to 26 in that October. In 1720, the South Sea stock was at 800 on September 1st, and a month later it was at 200.

Crashes without disease hysteria have been impressive and on this one the NYSE Comp dropped 29 percent in 16 trading days.

Financial strains always appear as a bubble gets overdone. Which ironically inspires boasts that nothing can go wrong. In January the head of Bridgewater stated that "Busts" were over. In December 2007, Harvard's Greg Mankiw boasted that failure was impossible because the Fed had a "dream team" of economists. Late in the 1929 Bubble, John Moody touted the "new" and "scientific" Federal Reserve System, while criticizing the old National Banking System. With the 1873 Bubble the "New York Herald" editorialized that nothing could go wrong. Why? Because the US did not have a central bank – it had the wonderful National Banking System. Unconstrained by a gold standard, the Treasury could issue any amount of liquidity.

The existing agency will be celebrated.

England hosted the senior economy and the contraction was such that in 1884 economists started calling it the "Great Depression". It was global and lasted until 1895, which has been the typical duration.

As this contraction continues, the public will have to "tighten its belt" and it will demand that spendthrift governments tighten as well. More specifically, they could condemn central bankers for blowing trillions of dollars in trying to prevent "bad things" from happening.

And then there is the absolutely absurd promotion that climate threats can only be eased by sending money and surrendering your freedom to the United Nations. As of this week, both the NY and LA times admired that the virus shutdowns are reducing the carbon “footprint”. Unhealthy citizens are helping to make the planet “healthy”.

Eventually, bureaucratic bungling in health, the economy and climate will be criticized. On the brighter side, too much in-your-face and in-your-wallet government is prompting another magnificent reform.