# Reflections

SEB

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## TINA, FOMO and looking back at a 300-year-old bubble

Stock market valuations are the highest since the dotcom bubble. Despite an ongoing pandemic, investor risk appetite is high. A lack of alternatives to equities when interest rates and bond yields are record-low is one explanation, but how long can we expect TINA to prop up stock markets? Aside from TINA, there is also FOMO, the psychological stress of standing on the sidelines as prices surge higher. This is a classic warning sign of a bubble. Yet bubbles are hard to identify in advance and it is even harder to predict when they will burst. What does it usually look like when bubbles build up? What can we learn from history?

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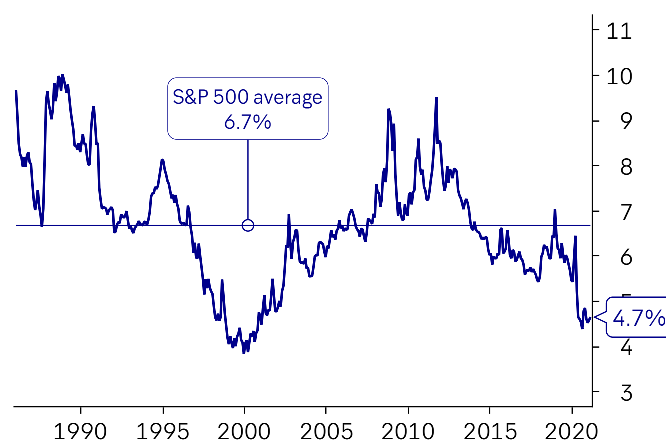
Almost anyone who wants to buy assets today encounters the problem that everything has become so terribly expensive. Real estate is pricier than ever. If you want to invest in forests or farmland, the same is true. Bitcoin have broken numerous new price records, yet it is no longer the worst. On stock exchanges today, you will find many companies that have seen increases of several hundred or even 1,000% in less than a year. Meanwhile a global pandemic is under way, causing world economic growth to fall and unemployment to rise. This only makes stock market euphoria harder to understand. But if you add an unprecedented dose of fiscal stimulus, funded by newly printed money supplied by the world's central banks, it becomes a bit easier to grasp. An abundance of risk capital has created an enormous desire for investment opportunities. This, in turn, has led many companies to go public, where they now sell their shares at prices that only a few years ago would have seemed like science fiction. Those of you who have followed stock market developments in recent years have probably heard two expressions used to explain this powerful trend: TINA and FOMO.

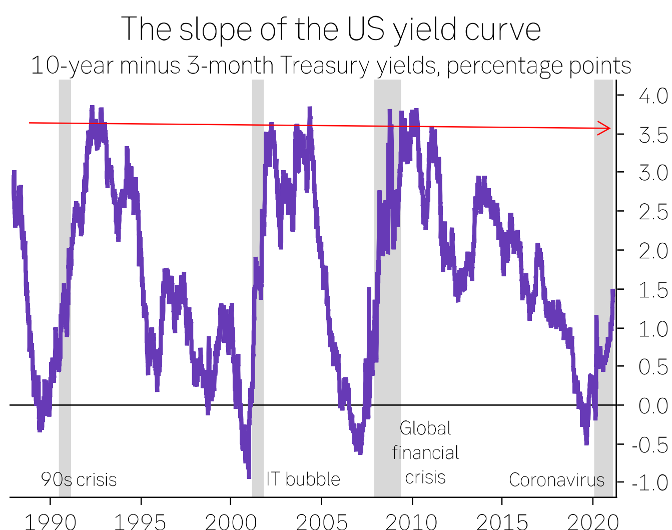
Let's think a little about these two driving forces and how long we can count on them to support share prices. We can start with TINA, which stands for "There Is No Alternative": the fact that returns on bonds and other safe assets are now so low that in practice there are no other alternatives besides buying shares of companies.

**With all due respect for TINA, how long will it last?**
Today's stock market valuations are at their highest level since the IT (or dotcom) bubble two decades ago, but as long as interest rates and bond yields are record-low, high valuations are not a problem. Besides, equities are still providing significantly better returns than bonds. The expected return on both the broad Stockholm share price index in Sweden and the S&P 500 index in the United States is now roughly 4.7%. Although this is the lowest level in 20 years, it is still far better than the fixed income market can offer.4

S&P 500 expected returns




But equities are preferable to bond yields because the latter are expected to remain low for a long time. Is that reasonable? With their ultra-loose monetary policies, central banks are guaranteeing that the party will continue. The US Federal Reserve has solemnly pledged to keep interest rates near zero for the foreseeable future. Sweden's Riksbank is saying the same thing. So there is nothing to worry about, and everything is hunky-dory. Or is it? Yes and no. One thing to worry about is what will happen to long-term yields. The market often refers to the spread between a 10-year bond yield and a three-month yield as "the slope of the yield curve". In the US, the yield curve has been an unbeatable recession indicator for more than half a century. When the slope turns negative (i.e. long-term yields become lower than short-term ones), it is a signal that we will have a new recession. The last time the curve turned negative was in 2019, so in a somewhat miraculous way, the yield curve thus managed to predict the recession caused by the pandemic. But the yield curve also shows other patterns. After the curve has been negative for a while, it usually starts to rise, or steepen, rather quickly. After all the previous recessions since the 1990s, the spread (10- year minus 3-month yields) has risen to about 3.5%.




If the same pattern repeats itself this time, 10-year US Treasury yields would keep climbing from around 1.2% today to 3.5%, even if the Fed holds its key interest rate at near zero. The question for equity investors is: How convincing is the TINA argument if you can earn 3.5% on a US Treasury bond? Worries about rising US long-term yields will not diminish when we consider that this year's US Treasury bond supply (i.e. how much the federal government borrows) looks set to be almost three times higher than the amount the Fed has said it will buy.

**FOMO – a genuine bubble argument**
The next argument – FOMO (Fear Of Missing Out) – is more complicated, since it has more to do with psychology than numbers. FOMO is about the stress you feel as an investor when you stand by and watch prices keep climbing, as your friends and acquaintances become filthy rich while your own fortune remains stagnant.

Because FOMO is about how our brains work, the phenomenon is as old as humanity. There are plenty of examples throughout history of investors being sucked into bubbles. But what do we actually know about financial market bubbles, and when do they usually form?

**What are favourable conditions for the emergence of bubbles?**
ECB executive board member Isabel Schnabel and economics researcher Markus Brunnermeier have studied financial market bubbles that have occurred over the past 400 years and have managed to identify some of the circumstances often needed in order for bubbles to occur. Historically, bubbles often emerge when the macroeconomic environment is characterised by:

1. Expansionary monetary policies
2. Strong growth in lending
3. Inflows of fresh capital
4. Financial market innovation or deregulation

Looking at the current situation, there is thus no doubt that it easily fulfils the macroeconomic conditions for bubble creation. Today's monetary policy expansion is unparalleled in modern times. Lending growth is strong, and ultra-low interest rates/yields combined with central banks asset purchases are forcing investors to choose riskier assets, so the influx of risk capital into the stock market is bigger than ever. Swedish newspaper Dagens Industri recently estimated that this year, more new money will pour into the Stockholm stock exchange in the form of IPO's than during the entire 2010s.

Bubbles are nothing new, and the term itself was coined 300 years ago in the 1720s after what became known as the South Sea Bubble in England. At the time, the South Sea Company had a monopoly on lucrative trade between Africa and South America, triggering hysteria about the company's golden future. Scientist and mathematician Sir Isaac Newton was one of those attracted by the hype. He invested early, and after a while he sold his shares at a good profit. The problem was that the share price only kept climbing. Newton, who then stood by and watched as his friends became richer, suffered from severe FOMO. He jumped on the bandwagon again with a huge investment close to the peak and was almost ruined in the ensuing crash. He is said to have then declared:

*"I can calculate the motions of the heavenly bodies, but not the madness of people".*

One effect of bubbles is that they create a widespread attitude that it is easy to make big money quickly and without effort. In the 1720s, this led investors to an intensive search for other companies with as much potential as the South Sea Company. With risk appetite peaking and a large queue of investors eager to make quick money, many new companies emerged. They expanded rapidly and then, like bubbles, suddenly imploded into empty nothingness. Among the more catastrophic projects that managed to attract money during this period were a company that said it could make planks out of sawdust and another that claimed it could extract solar energy from cucumbers. Perhaps the most illustrative example of the hype then circulating was a company that presented its business concept like this: *"A company for carrying on an undertaking of great advantage but nobody can know what it is".*

"A company for carrying on an undertaking of great advantage but nobody can know what it is"

Without drawing any further parallels, anyone who was around during the IT bubble can probably recognise themselves. In 1999 a company could make its share price soar simply by saying that it would start investing in IT, even if it had neither in-house knowhow nor a sensible plan for how to do this. IPOs with a connection to the internet or e-commerce could rise 100% without anyone questioning whether this made sense. My impression is that we have a similar mentality today, with fewer and fewer people interested anymore in shares that are expected to gain 5-7% in the coming year. One successful American YouTuber whom I follow said recently quite seriously that he aimed to double his net worth during 2021.

**To buy or not to buy, that is the question ...**
So how should we act? Well, even for those who suspect that we have a bubble in the stock market right now, the answer is still not as simple as just selling everything and waiting for the crash. We have to bear in mind that bubbles are notoriously hard to identify with certainty in advance, but it is even harder to predict when they will burst. A bubble can continue to grow for years if conditions are right, and then it can be expensive to stand on the sidelines and watch.

Not easy, in other words. Personally, I became aware of a small American solar energy company a while ago. It has an exciting new technology for making transparent solar panels and, from what I can tell, a trustworthy CEO. In addition, Alexandra Musk (Elon's half-sister) is part of the company's management. Wow, on paper it can hardly get better. Making it far more difficult is that the share price has already risen by several hundred per cent in a few months. You are probably wondering whether I invested in this company. Well, yes. FOMO has some power over me too. Now I am at least on the bandwagon, and the future will reveal whether it will be a pleasant journey or one that ends with a crash. In the latter case, I can at least take comfort in the fact that I am no worse than Sir Isaac Newton...