



LET'S TALK ABOUT...

FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

From Bubble to Bubble

(Part Two) The coming ride through the most significant “bubble stories” of the latest centuries, from the tulips in the XVII century’s Holland to the South Sea Company, from the maverick banking enterprises of the late 1800 to the black 1929, the Internet and the New Economy, will show how history repeats itself with astonishing recurrent patterns. Moreover it is a way to compare the real evidence of human behaviors, with the theories of efficient markets, thus reminding those psychological, sociological and historical factors which combine – and more often collide - with the dominant, albeit currently a bit discredited, mathematical-statistically based models. When considering speculative bubbles from a historical-behavioral perspective, another theme arises, that is the one of cyclicity, the swingings which regularly mark the evolutions of economic and financial scenarios, with different “wave lengths”, from the very short to the secular ones, like the most renowned Kondratieff wave.

If speculative bubbles are sort of “anomalies” or “deviations” from the efficient and theoretically elegant models set by illustrious scholars, including some Nobel laureates, we will consider some of such deviations, in terms of market actors’ behaviors. Because bubbles are mere mirages aimed at huge and easy gains – and several actors actually succeed in that – in an environment dominated by a major innovation, a new discovery, a need becoming suddenly perceived by many, within a curve of strong upturns then followed by blows and dramatic falls, drastic interventions and, of course, a late search for the culprits. Often central banks and their monetary policies, as well as supervision institutions, are held responsible for that, but indeed the real culprits are the eagerness of many, the unscrupulousness of some and, above all, that irrationality which, like it or not, dominates the financial markets just any other areas of human activity. - *GLT*

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(Part One) Our next articles will be centered on “bubbles”, as speculative phases continuously marking economic and financial evolutions. We will consider how bubbles are not just a matter of modern times, but rather colourful stories belonging to the past centuries too. It will be an opportunity to review and mix different perspectives – historical, technical, statistical, psychological – we previously mentioned in these columns. The bubble phenomenon is particularly interesting when analyzed in an experimental way, that is as a sort of lab test, looking at its beginning, growth and final more or less dramatic blow.

A common pattern then appears, again and again for any bubble, whatever the time and the surrounding scenario: an item of novelty, taking the mirage of easy enrichment with it, that is the rapid multiplication of money, most often through a leverage effect, and a dragging trend by an elite, progressively involving more and more waves of investors. The innovative factor becomes a trendy fashion, or even a mania, and the strong demand takes to huge and sudden increases in prices, so appealing even more investors, who consider the positive trend as irreversible and sustainable forever. It is a phenomenon of speculation, imitation and irrationality, which however continuously repeats itself throughout the centuries. And the second part of the pattern is always the same, as at a certain point doubts emerge about the price levels and their sustainability, and questions arise about the “real value” of that instrument or commodity, and some actors, likely the first one in inflating the bubble and taking the main profits, get out of the stage, so inducing a sort of avalanche effect, with increasing sales and no more demand. Panic selling then arises and prices collapse. Moreover, the public institutions which had benefited from the increasing money supply the bubble created, are now inexorably called out to rescue the distressed involved institutions and to act as lenders of last resort. The history repeats itself, and current events clearly and furtherly give evidence of that. *(to be continued)- GLT*

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