



**LET'S TALK ABOUT...**

FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

## Bubble Flower

**(Part Three)** After many months of skyrocketing price increases in tulip bulbs, growing investments in them by larger and larger groups of Dutch people of any social and economic conditions, increasing borrowing aimed at such placements, several moves designed in support of this collective maniac folly, the turning point came during February 1637. As for any kind of speculative bubble it is difficult, not to say almost impossible, to determine which factors concurred in causing the u-turn. Certainly many elements, most of them psychological and sociological in nature, usually converge in fueling the bubble as well as in starting its burst. And, as we already noted in reviewing Minsky's view and its rich actual evidences, the longer an artificial condition lasts and self-fuels, so to make anormality an almost-normal state, the faster and more dramatic the subsequent downturn is. And that was the case in the XVII Century's Holland for the tulip bulbs' market: those who held them physically started questioning about their more or less fair and reasonable prices, then trying to sell at the high prices they had reached, often in vain, and the spreading doubts and worries among the investors, as well as the increasing difficulties in repaying debts, made the market collapse, with diffused panic sellings and dramatic consequences. Many defaulting debtors were sued and put on trials but, after evaluating what had happened, judges came to state that those stories were not so much commercial transactions but rather betting plays, so that lawsuits against them were not admissible.

We can say that the tulips' story indeed shows all the main features of a "modern" financial speculative bubble, forerunner, in historical terms, of the many next ones which, as far as today, mark the financial history: a new element able to attract general interest, a group of promoters who exploit the new trend, spreading masses of investors more and more aimed at rapid and high returns, the use of borrowing for leveraging purposes, the use of particular kinds of contracts and instruments in order to bet on price trends, dramatic collapses, huge losses of capitals and savings, the lack of rules and controls, the final vain search for culprits. However, other similar stories, all the same intriguing, were to follow soon. -GLT

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**(Part Two)** The great tulips' bubble in the XVII Century Holland, with more and more people investing lots of money and borrowing heavily in order to pursue the mirage of easy and quick returns, also shows some peculiar "modern" features. On one hand the tulips' market generated kinds of contracts much alike contemporary options: the flowers' traders were able to secure the bulbs' supplies at predefined prices, thus hedging against sudden market upturns (just as in a typical call options contract), whereas growers could get a certain sale price for future deliveries by paying a premium (as in put options contracts). The bulbs' trade spread from the capital to smaller cities and towns, through a well structured network and many people, although not interested in the "physical" trade of the flowers, all the same engaged in betting on their price evolutions, according to a pattern much similar to current *futures* contracts, that is by profiting on the differences between forecasted and current prices at the times of expirations, or suffering losses in adverse market trends.

Moreover, marketing moves were designed, much alike the sales parties so widely used in selling different items, including financial instruments: public meetings and social event were organized in order to present the investment opportunities and collect the investors' funds.

Finally, the speculative euphoria also took to macroeconomic consequences, not just as more and more groups of citizen got involved, even of low socioeconomical conditions, with huge borrowing aimed at increasing the investments in bulbs and multiplying potential return, but also because the skyrocketing prices of tulips, when so diffused and unrestrained, unavoidably took to a general increase for all products' prices, including the basic ones. Then authorities had to intervene. The speculative bubble reached its climax (whose prove may be seen in the price of today's USD 50,000 for a single bulb, although particularly rare) in the autumn of 1636 and during the first months of 1637: at that point, the turning point and the "boom" came and stroke the tulips' market. *(to be continued)*-

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## Bubble Flower

**(Part One)** One of the most emblematic and typical cases of speculative bubble – not the absolute first in history but most cited and renowned - took place in the XVII Century Holland and involved the national flower, although not indigenous but imported, the tulip, since then cited as “the flower which drove people mad”. Tulips had been taken to Holland from the Levant during the previous century, and had fascinated for their charming shape and particularly the huge number of their possible colour variants – over 150 – some of them coming from natural selections, otherwise the results of experiments or bulbs’ diseases: these ones often generating extremely rare and most requested colour tonalities. The interest for the flower and its rarest variants, in aesthetical as well as investment opportunity terms, went on spreading, attracting more and more people, until generating a diffused sort of mania, strong chases for rarities and the creation of a well established speculative market. It is worth reminding that the XVII Century Dutch environment was particularly suitable for such a story, that is the development of a large-based investment market, centered on tulips like negotiable assets. Holland had actually established the first stock exchange, with official listings and tradings, as a result of its commercial and maritime relevances at that time. The Dutch Borse was the more structured evolution of a previous financial institution which already existed in the Republic of Genoa long before, the *commenda* ( the *Palazzo della Commenda* still exists, were “shouting” offers were launched to the public): it allowed shipowners and traders to collect money from private investors for their mercantile enterprises, thus sharing rewards and risks linked seafaring uncertainties and dangers, and other negative occurrences. Turning back to our precious commodities, the tulips, with figures, it may be interesting to note that the average salary of a good craftsman in Amsterdam might be about 250 Florins per year at that time (worth about some 3,000-3,500 US Dollars today). Well, in 1637 a rarest tulip’s bulb, the “*Semper Augustus*”, due to the strong demand and the generalized madness, was auctioned for 5,200 Florins, that is about 65,000 Dollars today ! (*to be continued*)- GLT

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