

Internet insanity, tulips, and derivatives

by John Hoefle

When the guardians of the biggest financial bubble in world history suddenly begin talking about bubbles, you know two things right away: First, that they're scared, and second, that they're lying.

Take the *Washington Post*, for example. The *Post*, with its tight connection to the Lazard Frères investment bank, has long used its business page to conduit the demands of the financial oligarchy to the Federal government; it has steadfastly denied the existence of the bubble, instead asserting at every opportunity that the U.S. economy is "fundamentally sound," and that the financial markets are the high-water mark of human economic activity.

"The Internet is pumping up one of the greatest speculative bubbles since Europe went gaga over tulips in the 17th century," the *Washington Post's* Jerry Knight wrote on Jan. 18. "The Internet market is going crazy."

The Internet market is indeed going crazy, with companies which have yet to—and may never—turn a profit, suddenly worth billions of dollars. But to single out the billions of dollars of Internet stocks as a bubble in a world awash with trillions of unpayable derivatives and other financial claims, is dishonest.

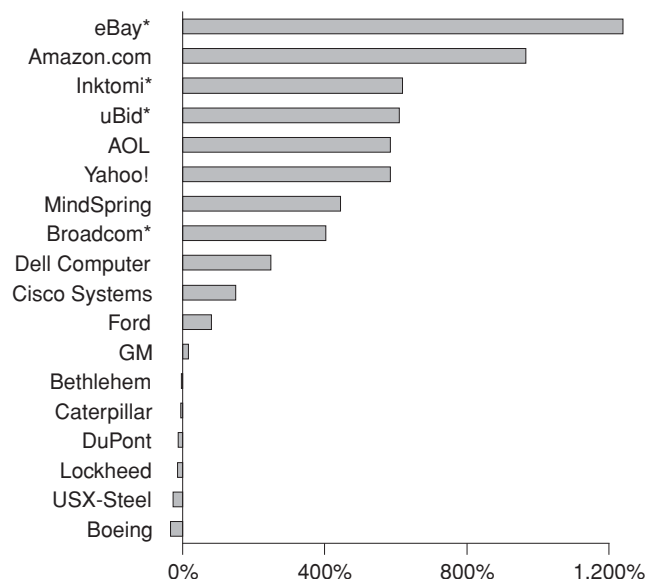
The widespread linkage of the Internet stock bubble to the tulip and other historical bubbles, of which the *Washington Post's* comments are just one example, is actually designed to protect the larger bubble, by cooling off the Internet frenzy, lest the collapse of the Internet stocks jeopardize the global derivatives rescue operations now under way.

Feeding frenzy

The Internet mania is based on the false assumption that the so-called Information Age can replace the Industrial Age as the engine of economic progress. Investors hoping to get in on the ground floor of the "information revolution" have been pouring money into Internet and Internet-related companies at an astounding rate, driving their stock prices to incredible levels.

The most egregious example is eBay, the Internet-based auction house which uses its World-Wide Web site to match up buyers and sellers for all sorts of goods. On Sept. 23, 1998, eBay went public through an initial public offering (IPO), offering shares at \$18 each. At the close of 1998, eBay's shares were trading at \$241 on the NASDAQ exchange, an increase of 1,240% in just a little more three months (**Figure 1**), and topped \$300 in both December and January.

FIGURE 1
Change in stock price during 1998
(percent change)



* Partial year; went public during 1998.

Source: EIR.

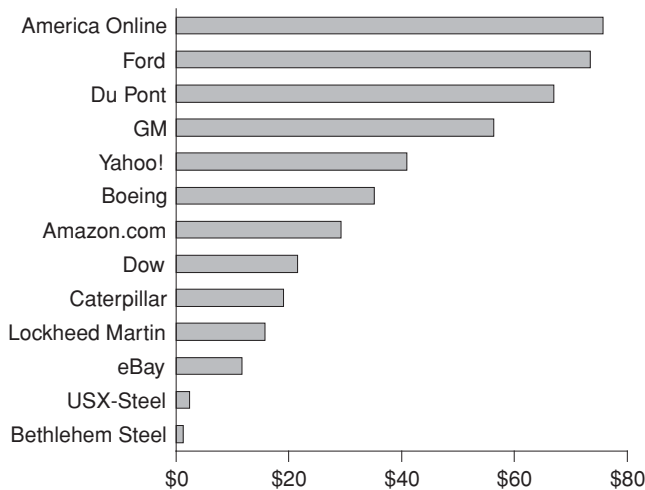
That a virtual flea market can grow so quickly, indicates the level to which virtual reality—and actual insanity—has taken over the markets. But eBay is hardly alone, as Internet stocks rose across the board in 1998: The stock of virtual bookstore Amazon.com rose 966%; the stock of search-software company Inktomi and flea market uBid rose some 620%, America Online rose 586%, Internet directory service Yahoo! rose 584%, and Internet service provider MindSpring rose 445%, among others. By comparison, the old industrial companies (which now have large financial service activities) seem downright stodgy. Ford's 82% increase in stock price, which is alarming on its own, looks conservative, as does General Motors's 18% increase. The declines at Bethlehem Steel, Caterpillar, DuPont, Lockheed Martin, USX-Steel, and Boeing reflect the accelerating collapse of the world's physical economy.

This sharp rise in Internet stock valuations has created huge companies out of thin air, at least as measured by market value. The market capitalization (the price per share times the number of shares outstanding) of America Online, was more than \$75 billion as of Jan. 11, making it larger than Ford, DuPont, and General Motors (**Figure 2**). Yahoo!, at \$56 billion, was larger than Boeing, and Amazon.com's \$29 billion put it well ahead of Dow Chemical, Caterpillar, and Lockheed Martin. Even eBay, the virtual flea market, is now one of the top 200 U.S. corporations in terms of market capitalization, leaving most industrial corporations in the dust.

FIGURE 2

Market capitalization, as of Jan. 11, 1999

(billions \$)



Source: EIR.

Back to reality

But the Internet bubble is a recent phenomenon, with most of the action taking place in the last four months, after the markets supposedly recovered from the near-meltdown triggered by last August’s “Russian” crisis, and the still unresolved “Asian” problems. Internet stocks like Theglobe.com and MarketWatch.com are able to grow 400-600% in value in one day, only because the system is already awash in fictitious capital—they are not the cause of the bubble, but rather creatures of it. One glance at the Dow Jones Industrial Average (Figure 3) should be enough to convince anyone who can still think, that the Internet frenzy is just the latest phase of a much larger, and more dangerous, game.

In fact, the stock markets themselves are just a sideshow, with the total value of all stocks on all U.S. stock markets combined, equal to at best 10% of the more than \$150 trillion notional principal value of all derivatives contracts outstanding globally, and equal to less than one-third of the \$55 trillion in derivatives contracts held by U.S. banks, securities firms, insurance companies, and other derivatives dealers.

It is the derivatives bubble which the pundits are trying to protect, with their warnings about the Internet stocks.

Compare the growth of U.S.-held derivatives to the growth of U.S. gross domestic product during the 1990s (Figure 4). In 1990, according to EIR’s estimates, there were \$9.6 trillion of derivatives in the United States, compared to a GDP of \$5.8 trillion, or \$1.65 in derivatives for every \$1 of GDP. By Sept. 30, 1998, the level of derivatives had increased 474% to \$55 trillion, while GDP had grown just 48%, to \$8.5 trillion, meaning that there were \$6.40 in derivatives for every \$1 of GDP.

FIGURE 3

Dow Jones Industrial Average weekly closings, 1900-97

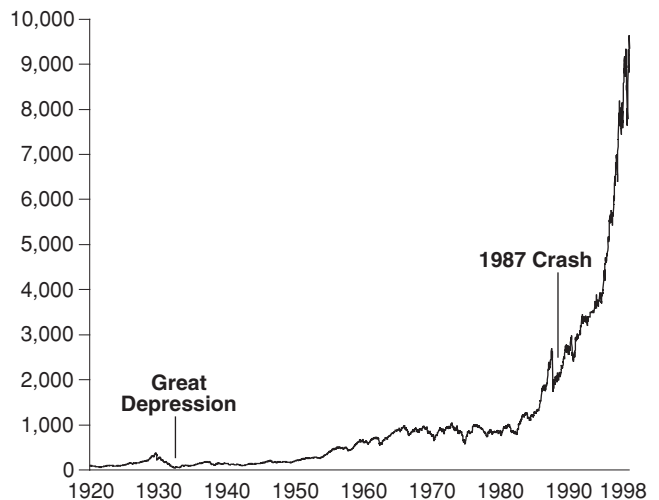
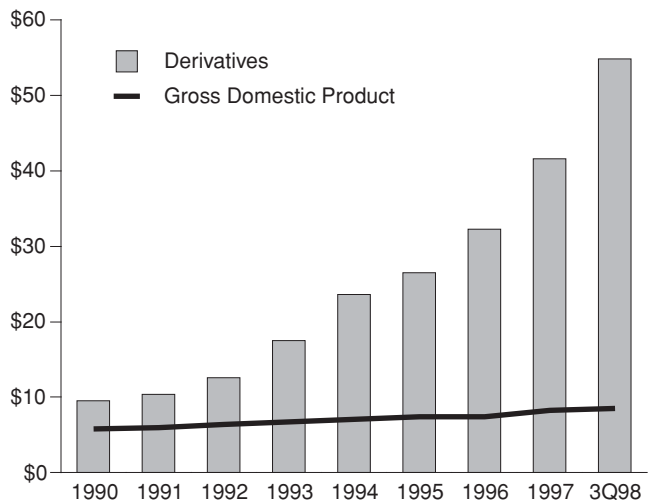


FIGURE 4

Derivatives versus GDP

(trillions \$)



Sources: EIR, Federal Reserve.

The reality is even worse, because only about one-third of U.S. GDP represents productive economic activity, with the other two-thirds representing overhead. Today, there are some \$15-20 in derivatives for every \$1 of productive activity, and that ratio is getting worse by the day, as the depression increases its hold, and the grow-or-blow bubble expands.