

## Waves of Asset Bubbles Over Time

What are asset bubbles? Do we recognize them beforehand or only after they have crashed?

An asset bubble exists when the price of the asset rises relative to the general level of prices in a given time frame. Asset bubbles are fed by ignoring economic fundamentals: historical norms in rates of return, a computed or imputed price-earnings ratio, and whether or not public policy feeds or reacts to increases in the price of an asset. As long as the price of an asset is seen to be increasing in value relative to the general price level, price momentum alone can drive speculation up to a point that is no longer sustainable. They are difficult to forecast, and thus to manage through public policy intervention, leading some to dismiss bubbles as momentary episodes that lead to self-correcting behavior in time.

What are some key dimensions of historic asset bubbles?

“Manias and panics, I contend, are associated on occasion with general irrationality or mob psychology. Often, the relationship between rational individuals and the irrational whole is more complex. After (1) mob psychology, we can distinguish a series of related cases: (2) people will change at different stages of a continuing process, starting rationally and, gradually at first, then more quickly, losing contact with reality; (3) rationality will differ among different groups of traders, investors, or speculator, including those at the earlier stages and those at the later; (4) all will succumb to the fallacy of composition, which asserts that from time to time the whole is other than the sum of its parts; (5) there will be failure of a market with rational expectations as to the quality of a reaction to a given stimulus to estimate the right quantity, especially when there are lags between stimulus and reaction; (6) irrationality may exist insofar as economic actors choose the wrong model, fail to take account of a particular and crucial bit of information, or go so far as to suppress information that does not conform to the model implicitly adopted.”

Charles Kindleberger-*Manias, Panics, and Crashes – A History of Financial Crises* (1978), p. 23.

## Asset bubbles over time:

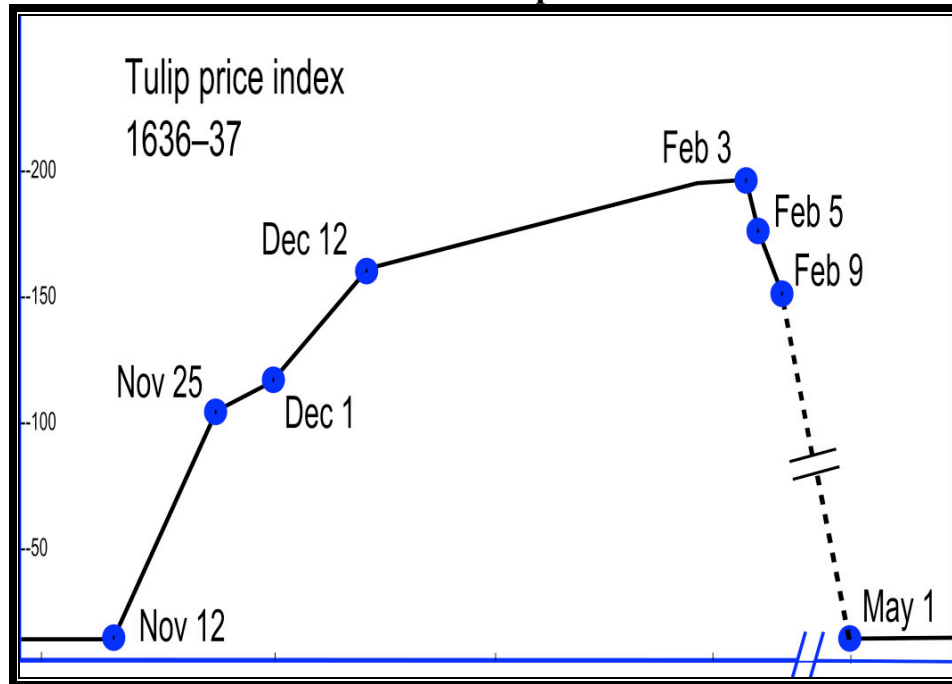
1. **Metallic coins** –Holy Roman Empire, 1618-1623
2. **Tulipmania** – Amsterdam, 1608-1625.
3. **Land Assets** – Dutch East India Company shares, canals, drainage projects, elegant houses, 1636-40
4. **British Government Debt** – Amsterdam, 1763
5. **Selected companies** – South Sea Company, *Compagnie d'Occident*, Sword Blade Bank, Banque Générale, Banque Royale, 1720; British East India Company, 1772; Dutch East India Company, 1772-1783.
6. **Import commodities:** sugar, coffee, 1799, 1857 in Hamburg, cotton in Britain and France, 1836, 1861; wheat in 1847
7. **Country banks** – England, 1750s, 1793, 1824
8. **Canals** - 1793, 1820s I Britain; 1823 in France
9. **Export goods** - 1810, 1816, 1836 for Britain
10. **Foreign bonds** – 1825 in London; 1888 in Paris; 1924 in New York; 1931-82 syndicated Third World bank debt
11. **Foreign mines** – Latin American in Britain, 1825; German in Britain and France, 1850; Rio Tinto, Gécamines, 1990-2010
12. **Foreign Direct Investment** – by U.S. companies, 1960s; by foreign firms in the U.S., 1980s (Sony investment in Rockefeller Center, purchase of Columbia records)
13. **U.S. Mutual Funds** – investing in Japanese shares, 1980s; emerging markets, 1993-1994
14. **Building sites:** 1825 in France, 1830-42, 1843-62, 1853-77 1878-98, and 1898-1933 in Chicago; 1872-3 in Berlin and Vienna; 1925 in Florida; 1970s and early 1980s in the Southwest United States and southern California; World Trade Center reconstruction, 2002-2012
15. **Agricultural land** – *bien nationaux* (noble land confiscated during the Revolution in France, speculated in from 1815 to 1830); farmland in the United States during World War I to 1921 and in the 1970s (up 83.3 percent in nine years, followed by a decline of 39 percent from 1981 to 1986).
16. **Public lands** – United States, 1836, 1857, Argentina, 1888-90; arctic drilling in Alaska 1970s-; fracking 2011-.
17. **Railroad shares** – 1836, 1847 in Britain; 1847, 1857 in France; 1857, 1873 in the United States (Crédit Mobilier); New York Central Railroad, Pennsylvania Railroad
18. **Joint-banks** – Germany, 1850s and early 1870s; Kréditanstalt 1931; Lehman Brothers 2008;
19. **Joint-stock discount houses** – Britain in the 1860s
20. **Private companies going public** – 1888 in Britain; 1928 in the United States; Facebook (2012), Twitter (2013), Tesla (2010), Microsoft (1986), Apple (1980)
21. **Existing and merged companies** – 1920 in Britain; 1928 in the United States; conglomerates in the United States, 1960s; from late 1960s to the 1980s, mergers and acquisitions in the United States; Hewlett-Packard merger with Compaq computer.
22. **Copper** – 1888 in France; 1907 in the United States
23. **Foreign exchange** – the mark in 1921-23; the franc in 1924-26; sterling in 1931, 1964, 1990; the dollar in 1973, especially the dollar that rose for five years to February 1985 and then sank for the next three years.
24. **Silver** – the Hunt Brothers, 1980s
25. **Gold:** that rose from \$200 an ounce at the beginning of 1979 to \$850 a year later, to fall below \$300 again after another year; the rise to \$1,700 peak and then the fallback to around \$1,100 in the aftermath of the Great Recession of 2008.
26. **New industries** – the United States in the 1920s, 1960s, technology shares 1995-2000 in

the dot.com boom.

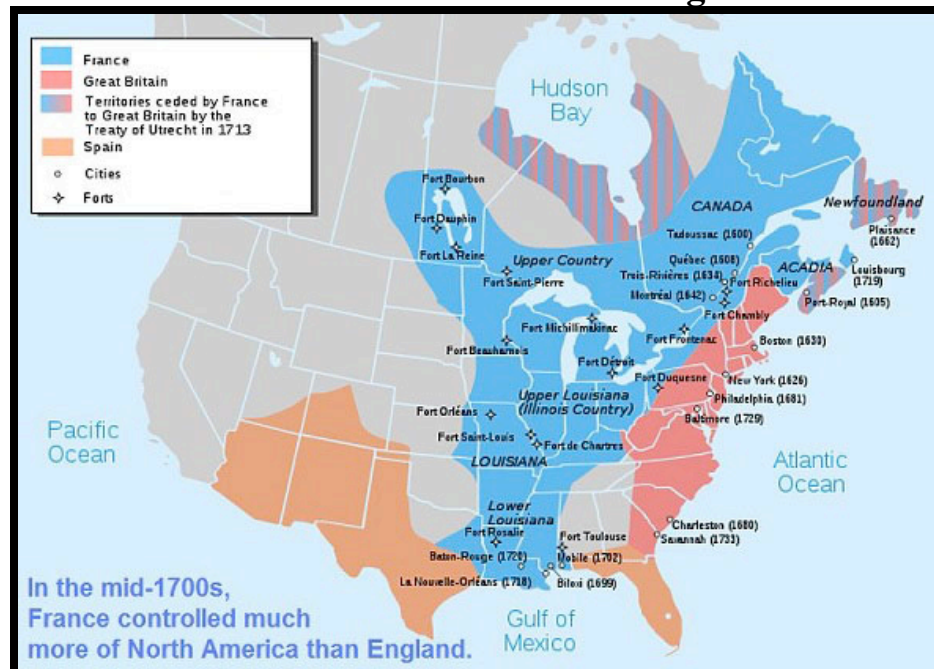
27. **Real estate** – Florida real estates in the 1920s; 1980s, building sites, developable tract, Real Estate Investment Trusts (REITS), office buildings, shopping malls, hotels, luxury housing, nursing homes, retirement complexes.
28. **Derivatives** – options and futures in commodities, foreign-exchange, Standard and Poor's 500 stock index, interest-rate indexes, Long-Term Capital Management (LCTM) 1994-2000.

## Pictures at an Exhibition:

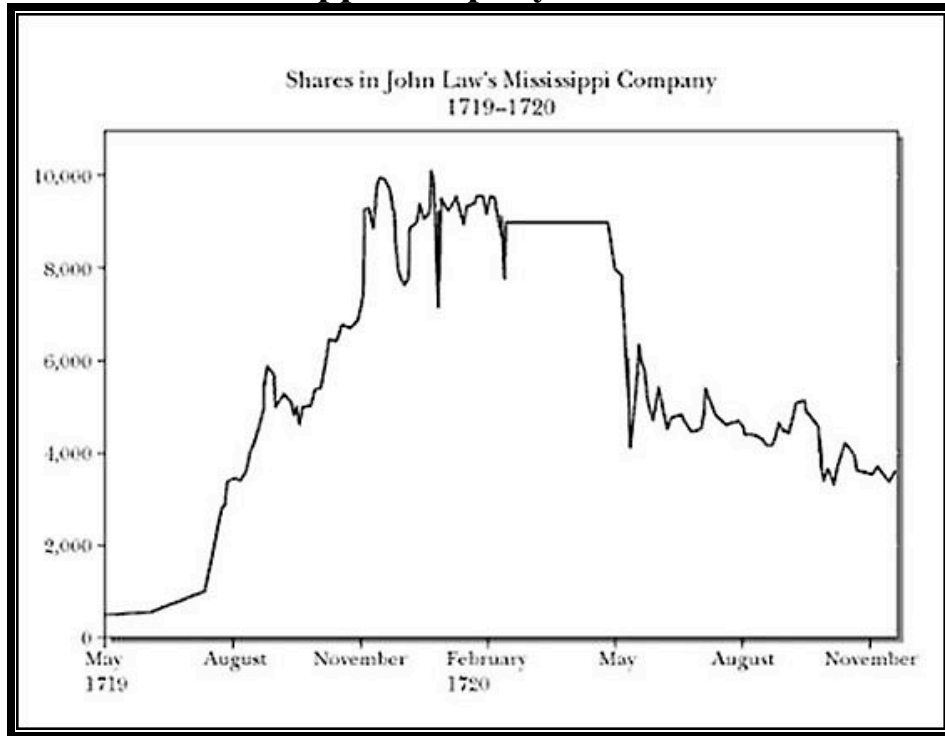
## The Dutch Tulip Bubble



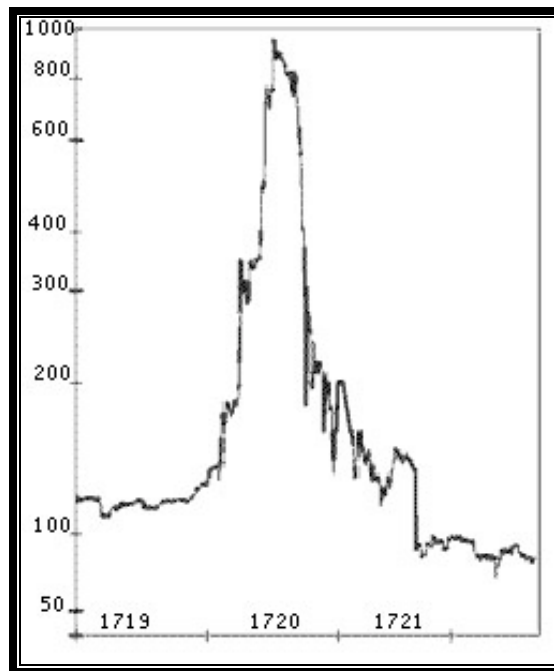
## French Territorial Holdings



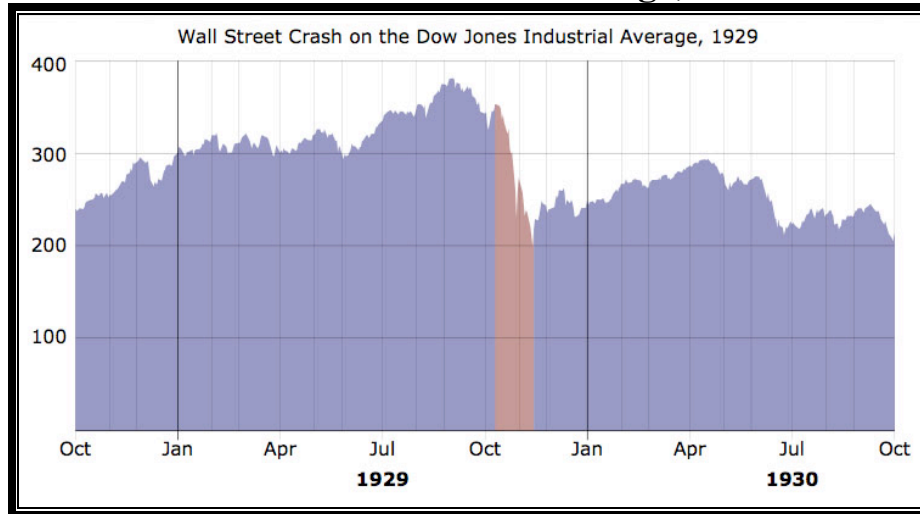
## Mississippi Company Share Prices



## The South Seas Bubble



## The Dow-Jones Industrial Average, 1928-1930



## The Dow-Jones Industrial Average, 1900-2015



## The Spot Price of Gold per Gram, 1971-2012

