



## Is the bull market a rational exuberance?

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THE Dhaka bull is charging on. The DSE General Index just crossed the millennium mark of 3000 — a lofty height once crossed briefly but precipitously in 1996. This time there seems no end in sight, notwithstanding all the chatter about doom and gloom and lack of business confidence. The DSE Index is up more than 75% year-to-date with market capitalisation reaching over 10% of GDP.

The question in everyone's mind, or at least in the mind of those who got their fingers burnt in the crash of 1996, must be: how long is the party going to last before the inevitable correction happens? No doubt this is a valid question, especially when one sees stock prices getting ahead of the economy. To see a stock market booming when the economy is not is an aberration that calls for much stronger explanation than what is usually heard on the street:

massive inflow of funds into the equity market — away from high-taxed savings instruments — has bid up stock prices as there is paucity of scripts in the market. This excess of demand over supply explanation is on thin ice as demand for stocks — unlike the demand for goods — is a derived demand reflecting interest in ownership of profitable companies. If a company is not profitable or shows no prospects of generating profits in the foreseeable future, any artificial escalation of its stock price is bound to be short-lived. This is a bare-bone fundamental proposition about equity values.

The argument that the significant presence of institutional investors in this market will prevent a repeat of the 1996 episode is also not convincing when one thinks of herd mentality in these markets. Institutions can hardly be expected to be left holding assets when their values are shrinking.

What might be surprising to many observers is the timing of this boom. Is it simply keeping step with the booming markets in the neighbourhood — India and Pakistan? Both the Mumbai Sensex and Karachi Stock Exchange Indexes are up more than 40% for the year. But the lack of any integration with these markets should put even this hypothesis to rest.

How about trends in the global equity markets? To be sure, the leading stock indexes of the world — US DOW, UK's FTSE, Germany's DAX, France's CAC, Japan's Nikkei, Hong Kong's Hang Seng — all have a tendency to move in tandem these days due to rising integration of global financial markets. Typically, it is the US Dow Jones Industrials that leads the way, for others to follow. After a long pause since the downturn of 2000, the year 2007 has been a stellar year for the global stock markets, until the sub-prime mortgage crisis broke out in the USA some three-four months ago. Then all hell broke loose. Despite concerted efforts of Group of Seven (G-7) central banks to pump in liquidity, leading stock markets around the globe continue to remain volatile to this day. Speculation is ripe that the ripple effect of the US mortgage debacle will extend well beyond the major US banks to financial institutions across Europe, and even Australia, depending on their exposure to US mortgage debt instruments. I would hazard a guess that the full economic impact of this fiasco has not played out yet.

For better or worse, Bangladesh equity markets is largely immune to these developments for at least two reasons: (a) non-convertibility of the capital accounts of our balance of payments, which precludes Bangladeshis to have a stake in foreign equity investments; and

(b) negligible flow of foreign portfolio investment — which represent footloose foreign funds in the economy that takes flight at the slightest sign of trouble. It is these characteristics that also kept the Bangladesh economy from being roiled by the East Asian financial crisis of 1997.

That having said, it is also true that our equity markets could be run aground by the machinations of internal implosive forces without warning. Veteran stock market watchers have opined that it is well nigh impossible to tell when equity prices are over-valued, and you cannot fight market forces which have their own momentum. The fact of the matter is that when stock market appreciation is largely a speculative bubble, the inevitable finale of the bubble bursting cannot be too far off. It is the timing of that downturn which is impossible to predict.

Seeing the present state of our bull market, one cannot but help recall the anguish of the former US Federal Reserve Chairman, Allan Greenspan, at the booming US stock market of the 1990s. Although the Fed's mandate was to control inflation, not asset prices, he felt the runaway appreciation of asset values could eventually lead to disastrous consequences on the health of the economy. So in December 2005, in his famous address to the American Enterprise Institute, he described the unduly escalated asset values as the result of "irrational exuberance" of investors. That expression soon became a catchphrase for describing stock market booms driven more by speculation than market fundamentals.

The stock market in Bangladesh has undergone significant improvements since the setback of 1996. Scripless trading through the central depository now covers some 118 firms and nearly 75% of market capitalisation. The Securities and Exchange Commission has introduced many regulatory measures to thwart debilitating speculative maneuvers and detect stockprice manipulations via heightened monitoring. Nevertheless, it is important to keep in mind that paper values are nothing but. Stock prices cannot be taken for granted. Though fortunes have been made by many in these markets, at bottom, it is a risky investment. In an earlier editorial in this paper, small investors were cautioned to beware. A final word of advice: the stock market is no place to put your hard-earned life's savings.