LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

> Nowhere does history indulge in repetitions so often or so uniformly as in Wall Street. When you read contemporary accounts of booms or panics, the one thing that strikes you most forcibly is how little either stock speculation or stock speculators today differ from yesterday. The game does not change and neither does human nature.
>
> – Edwin Lefevre
> *Reminiscences of a Stock Operator* (1923)

A price bubble is generally defined as a deviation in the price of an asset (gold, foreign currency, real estate, or stock) from the price consistent with its fundamentals. These bubbles or manias have occurred throughout history. One of the earliest and most frequently cited manias, tulipomania, occurred in Holland in the 1630s when prized tulip bulbs sold for 10 times the price of a townhouse.

The bubble metaphor was not applied to speculative excesses until the time of the South Sea Bubble in 1720. The British government had run up debts in wars and was running into difficulties servicing those debts. A common way out of this problem at the time was to confer trading privileges on a company in exchange for that company's assuming the government's debt. The South Sea Company agreed to such a plan and was given a monopoly of the trade to the South Seas. In turn, the Company offered to issue shares to the holders of the government debt. The Company fostered extravagant ideas about the riches of South America which resulted in its shares rising, which enticed holders of government debt to convert to company shares and an eventual collapse as the folly of the scheme was realized.

Both of these early bubbles attained a level of financial sophistication similar to what is seen today. In both Amsterdam and London, financial derivatives were used to contain risk and enable speculation. For example, tulip futures were utilized to enable trading while the bulbs were in the ground.

In, *Devil Take the Hindmost: A History of Financial Speculation*, Edward Chancellor states, "The Austrian economist J. A. Schumpeter observed that speculative manias commonly occur at the inception of a new industry or technology when people overestimate the potential gains and too much capital is attracted to new ventures." This observation is supported by Eugene N. White in *Crashes and Panics: The Lessons from History*, where he states, "Surveying the bubbles from the seventeenth century to the present, the principal factor that leads to the emergence of a bubble is that the underlying fundamentals of the asset in question, be they stocks or tulips, cease to be well identified. This may be the result of some innovation, technological change, or change in the structure of the economy. These developments make predictions of future earnings more difficult . . ." With regard to tulipomania he points out, "The ability and speed with which rare varieties could be multiplied was not yet well-known. . ." and in the case of the South Sea Bubble, ". . . the exact gains from more liquid assets and the privileges conferred on the South Sea Company were extraordinarily difficult to measure."

In remarkably similar fashion, bubbles have appeared repeatedly over the last four hundred years. Bubbles were associated with development of the canals, railroads, electricity, the automobile, the radio, the airplane, computers, and most recently, the Internet. Perhaps the greatest bubble of all time occurred in Japan in the 1980s. In terms of the Japanese bubble, we generally think of their stock market. However, land speculation was even more intense. At the peak, the grounds of the Imperial Palace in Tokyo were estimated to have a greater value than all of California. Little has changed since the early bubbles because, as Edwin Lefevre said, human nature does not change.

April, 2001