Watch Out for the Greed Syndrome

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Extremes in the financial markets could be characterized by periods of greed and fear. Once there is a unanimous opinion of the economic and market outlook, marginal investors expect to see larger rallies in a bull market and greater declines in a bear market. When those marginal forces affect the value of the overall stock market, a coming change in direction is likely. For example, back in the early months of 2000, after a five-year rally in the stock market, workers in some companies were complaining that their 401k values were not growing fast enough. Inquiries to corporate managers had to deal with demands that the 401k fund be invested in selected technology funds that had recently risen to more than over 100% annually! One far-out experience found a knowledgeable investor liquidating his entire 401k invested in a portfolio of diversified mutual funds and invested all of it in Qualcomm stock! Even the mutual fund industry was not immune to this greed. A large value fund changed its strategy from value to growth in the first quarter of 2000, expecting growth to continue with unusual outperformance. The fund liquidated virtually all value stocks and bought the tech stock darlings.

We know what happened after that. A bear market ensued from April 2000 until the first quarter of 2003, hitting the growth stock sector especially hard. By early 2003, there were few, if any, optimistic investors left standing. Given the size of the latest rally that began in 2019, it may be time to stay alert to the possibility that the greed syndrome will emerge again. One statistic to monitor is the level of margin loans against stock portfolios. The speculators who choose the stock market as a gambling option, increase their margin loans to invest in an ongoing bull market. In today's environment, speculators are increasing their margin loans, though interest rates exceed double-digit rates. According to the latest data from FINRA, as of November 2024, the total margin debt in the U.S. stands at approximately $890.85 billion, the highest level since February 2022. If such speculation continues, we will become concerned about stock market volatility, as any severe correction could force many speculators to sell stock to satisfy their margin loan requirements.

Another example is that we have inquiries about introducing portfolios consisting of more aggressive investments. One or two of such inquiries are not that concerning, but if a pattern emerges that signals that average investors are looking to take on more risk, that is a second warning to become cautious. Remember a past chairman of the Federal Reserve characterizing the 1998 stock market gain as reflecting "irrational exuberance?" From that point on, the market's peak was more than two years. So, even though signs of greed are beginning to emerge today, there could be more than a year or more before these cracks become a full-blown stock market decline. Not to be a Grinch, but it pays to be safe rather than sorry!

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