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‘What were those people thinking?’

On Wall Street, valuations of assets clearly are not jibing with what is happening in the economy

FINANCIAL FOCUS

Robert Smith

Irrational exuberance, anyone? I believe it was John Kenneth Galbraith, a committed Keynesian who famously said the financial memory is “notoriously short.”

How ironic then that fellow Keynesian and Alan Greenspan protégé Ben Bernanke, the Fed chairman, is doing everything possible to inflate yet another stock market bubble.

I must agree with Richard Lehmann when he says five years from now we will all look back and say, “What were those people thinking?”

This brings us to the reality gap – that yawning chasm between the real economy and current asset valuations. With the U.S. economy expected to grow at 1.8 percent this year and real incomes slumping 3.6 percent (the biggest monthly drop in 20 years), how else can we describe the difference between what’s happening on Main Street and what’s happening on Wall Street?

The stock market appears to be ignoring Main Street’s pain and concentrating exclusively on the Fed money machine. It correctly assumes that the country is now being run by the Fed and Bernanke. The only problem is that his policy of more, cheaper money has no history of ever working. If it did, Argentina would lead the world in terms of productivity and growth.

Perhaps higher stock and housing prices in the wake of slumping wages and declining consumer confidence make sense on Wall Street and in Washington, D.C.; however, they don’t make much sense to me. I am afraid that the powers that be are just setting Joe Six-Pack up for another fall. There’s nothing like being the last soldier at the Little Big Horn.

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According to Jim O’Neill, chairman of Goldman Sachs Asset Management, U.S. economic growth would have to accelerate to “ridiculously strong levels” to justify a substantive advance from here for the S&P. What chance is there of this happening when the recently re-elected visionary-in-chief has tasked the federal regulatory bureaucracy to review each of its decisions in light of renewed concern over climate change.

I would be foolish to think that Al Gore’s sellout to Al-Jazeera put that myth to rest. Such is the strength of true believers who soldier blindly on even after their prophet cuts the ground out from under their feet.

I am sure President Obama and his minions will use this fig leaf to stall or defeat real job creation engines like the Keystone Pipeline, hydraulic fracking and additional refining capacity to aid our energy boom. All this will deprive Main Street, the real economy, with much needed jobs and affordable energy.

Investors not wanting to lose more money on this next Fed-inspired bubble should understand who they’re really working for. According to Richard Lehmann, “while the Fed continues to pay lip service to reducing unemployment (Main Street), its real efforts are going into keeping interest rates artificially low and trying to stimulate inflation.”

First, this helps government by enabling it to borrow and spend more money. Next, it helps Wall Street by driving money into riskier assets. The one group it doesn’t help is Main Street.

The inflation and incumbent economic dislocation that will result are anathema to investors. Therefore, be very careful about joining this dance. When the music stops, there may not be a chair to sit on.

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