

GARY NORTH'S

REMNANT REVIEW

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Preparing the Remnant for the far side of the crisis

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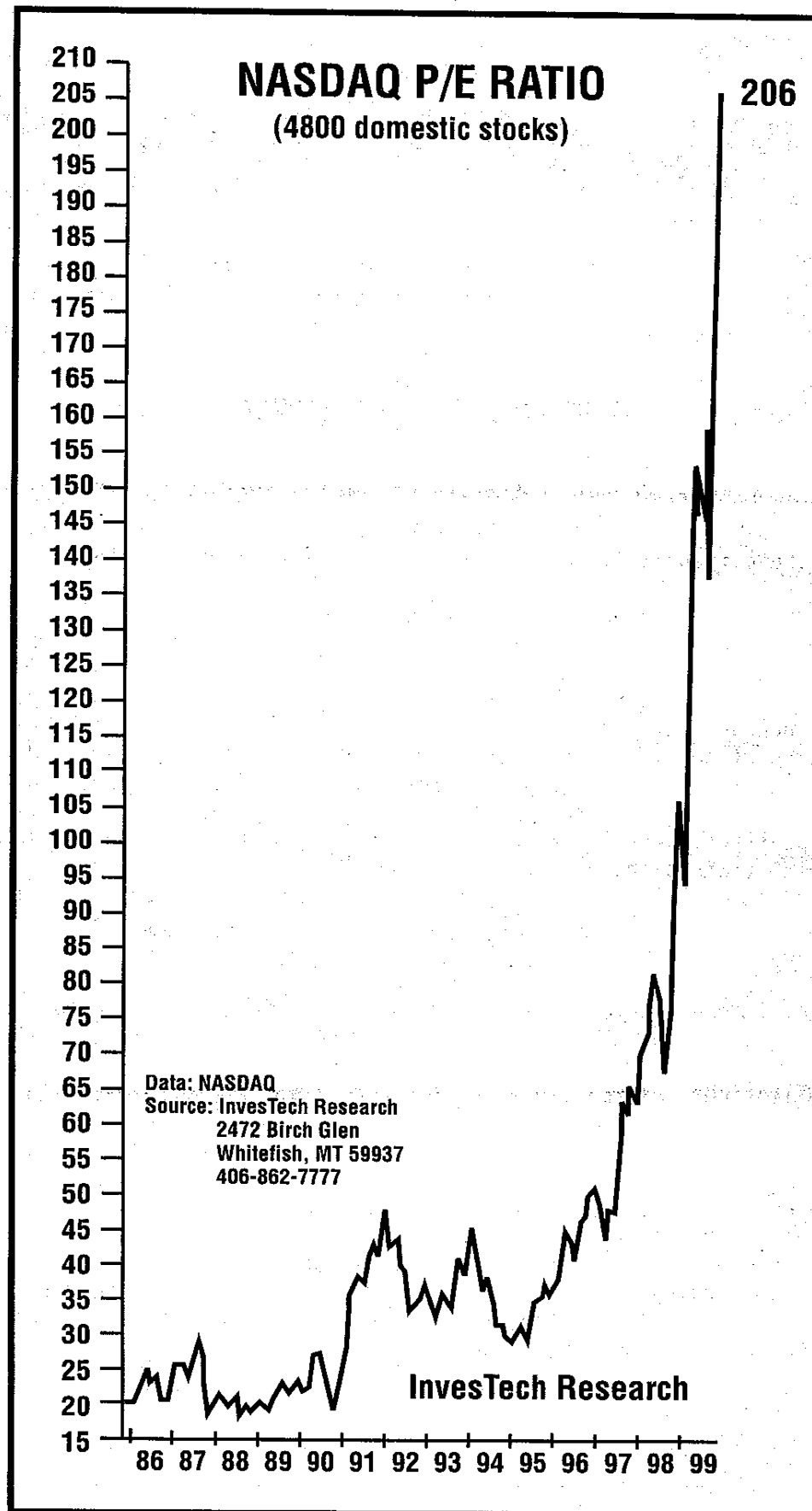
THE MADNESS OF CROWDS

The combined market valuation of the proposed Time Warner/AOL conglomerate is expected to be \$350 billion. That is more than the market valuation of Spain's stock market, according to Bill Bonner's *Daily Reckoning* (Jan. 14). The company will sell in the range of 200 times profits.

I use AOL as a back-up e-mail service. I pay \$5 a month for the service. There are 40 million users. AOL gets newcomers onto the Internet, but once onto the World Wide Web, AOL has no competitive advantage -- and far less tech support -- than a local Internet service provider. AOL has to keep people by means of its non-Web services and features -- suspiciously like the local bulletin boards of the late 1980's and early 1990's. But the power of the Web is so great that it overwhelms anything resembling a bulletin board. The sense of community necessary to sustain 40 million customers' interest is difficult to achieve, precisely because the customer base is so large. Breaking AOL down into sub-communities is the obvious way to go, but AOL has no powerful advantage over Yahoo! or other "Web portals." It has no advantage at all over specific Web sites -- millions of them today -- that offer very tightly focused information and chat forums.

Think of *Time* and *Life*. *Life*, *Look*, and *The Saturday Evening Post* did not survive the explosion of special-interest magazines of the 1960's. The fall in the price of color printing destroyed the advantage once available only to large publications. *Time* is now facing competition from the Web. To maintain its subscription base, it must become amorphous, compared to the Web, where *WorldNetDaily* and other ideologically focused news sources proliferate.

On the next page, I reprint a chart from *InvesTech*. When you see it, you will understand my belief that a market mania now governs investors, including mutual fund professionals. It charts changes in the price/earnings ratio of the NASDAQ stock exchange. This is the preferred exchange for investors who dream of great profits from companies that today have low earnings or none. NASDAQ has been in mania mode since 1997.



The basis of sustained increases in price is profitability. Without earnings, a stock rises only on expectations of future earnings. But when the entire NASDAQ looks like this, then mania has hit. Where will the earnings come from to validate a 206/1 P/E ratio? They won't. To spend \$206 to buy \$1 of earnings -- which are not dividends -- is irrational, except on the assumption of the "greater fool" theory.

There sits a stodgy U.S. government bond, paying well over \$6 per \$100. New investors don't consider anything so lackluster. Only in a recession or depression would there be capital gains to bonds through falling interest rates. Who expects a recession or a depression? No one under 50.

While the average stock has continued to fall in price in the last two years, the Internet and technology stocks soar to new heights. The discrepancy is becoming more obvious as time goes on. Investors are persuaded that the wave of the future is in Internet stocks. The wave of the future is assumed to be positive. But the discrepancy between the performance of the two worlds tells us that the mania cannot be sustained. When investors at last lose confidence in the ability of their portfolio to perform except on the basis of the "greater fool" theory, they will search for more conventional returns. When they do, a crash in this sector will take place. Reality will intrude.

There Is No Proven Model for the World Wide Web

What investors ignore and very few Web commentators discuss publicly is that almost no one is making a profit on the Web. There are a billion pages on the Web, and most of them are giveaways, subsidized by the page's owner. They sometimes serve a profitable purpose, such as FedEx or UPS tracking services, which reduce the pressure on their customer service divisions. But for the most part, Web sites are not contributing to anyone's bottom line.

That's because, in the words of a famous Web slogan, "information wants to be free." The statement is silly; information is a valuable resource that must be paid for by someone. But the Web's worldview longs for a day when information will be free. It's a kind of communism, or as Bob Serling calls it, **dot communism**. The millions of dot-coms on the Web are not turning a profit. Most of them never will.

It is not easy to build a well-trafficked Web site. Very few sites get much traffic. Even more difficult is to build an income stream from a Web site. Most difficult of all is building a profitable company. Where are those sites that have provided their owners with a positive rate of return? There is only one segment of the World Wide Web that has, so far: pornography. Here, the competition is fierce, but some people have made fortunes, although they do not brag about it. But these are rarely publicly traded companies.

Information will start costing people something when micro-billing technology appears: a fraction of a cent per page viewed, billed to a credit card. This technology is not here yet. The Web will become a serious producer of revenue only when this technology appears.

Today, the Web site operators are building market share -- visits or hits -- by means of their investors' money. They are selling goods at their cost only because their investors are buying stock on the assumption that someday,

somehow, management will find a way to charge for services rendered. This has yet to be proven.

The loyalty of viewers is not tested yet. The medium is too new. And there is another problem. It is said that any of these expanding firms can produce a profit any time it likes by just consolidating and reducing expenditures to grow. This has yet to be proven. How can one of these companies ever cease its quest for market share? First, there are English-language markets to conquer. Then there are the foreign language markets. When can any Web company climb off the back of this expansion tiger? Web business is growth-driven. But new technologies keep appearing that threaten any Web monopoly. The Web is too new for gaining monopoly returns, or even conventional returns. The Web is a gigantic P/E monster. It gobbles up its investors' capital and cries out for more.

The standard ways the information sites generate income are unproven. They sell banner ads, but unless these ads are designed to gain sales -- most are not -- they are fluff advertising. There is no indication that these ads pull anything more than marginal income.

Sites may sell items related to the their main topic. But to gain much revenue from sales, the items must be very specific, meaning that the site must be very specific. The viewer must have his hot button pressed very hard, which cannot be done with wide-audience advertising. This will move profit-seeking sites away from the broad magazine model and toward the special-interest, niche market model. The idea here is to create a dedicated following, and then sell items unique to the visitors' interests, preferably products not available anywhere else. But this kind of site is rare today, and very few large, publicly traded companies own them.

The Web favors price competition for broad-based products, cutting profit margins to the bone. Site managers try to make their money on volume and savings in costs. But it takes lots of money to promote a new site, usually through conventional media ads. To create a Yahoo! today would be very expensive. The dozen largest search engines dominate the market. But they are fiercely competitive. None of them can ease back and survive.

The pace of change and the size of the potential markets are so great today that none of these companies can afford to relax, sit back, and live off of the income. The market capitalization of expected earnings is so huge that the investors will not see their return. They do not calculate rates of return. They only see that if they had gotten in earlier, they would have made a fortune. This is the mark of a mania. It is what Charles Mackay wrote about a century ago in the first three chapters of his classic book, *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*. Yes, you can get it for free on the Web:

<http://www.bibliomania.com/NonFiction/Mackay/PopDelusions>

The first three chapters deal with investment manias of the early 18th century: the Mississippi Scheme, the South Sea Bubble, and the Tulipmania. In the boom phase, all were based on the greater fool theory. Expected returns from the actual assets' productivity had nothing to do with prices paid by investors.

Look at that InvesTech chart again. What would lure people into

investing in a company with a 206/1 P/E ratio? Only a mania, a belief that what future investors are willing to pay will have nothing to do with the stream of income from the underlying asset.

How much money did you spend on the Web in 1999? What was the percentage of this expenditure in your overall budget? I'll tell you: under 5%. People do not buy their staples on the Web. The Web will surely be more important as a source of the things that people buy as time goes on, but the P/E ratios today are discounting decades or centuries into the future.

There is something else. Without a working Web model for profitability, there is no way that investors can know which Web companies will survive and prosper. There will be the usual shake-out of unprofitable companies as soon as the mania ends and investors' funds are not used to attain market share at the expense of profits.

But investors no longer fear the market cycle. The FED has successfully delayed the arrival of another recession since 1993. Investors have short memories. They see a boom, which becomes a mania, and they search for any explanation other than greed and government intervention that favors a particular market. They seek out reasons why 6% per annum is not sufficiently attractive. They go looking for a "new paradigm." There are always people ready to sell them a new paradigm.

The Monetary Control Act of 1980

Two decades ago, Congress passed a law that deregulated banking. The long-time interest rate ceiling that limited what banks could pay as interest was abolished. Second, the bank insurance limit was raised to \$100,000. This took investors' risk out of investing with thrift institutions. The combination of these two provisions enabled the savings & loan industry to offer depositors very high rates. To achieve these high rates, the managers too often invested in high-risk, illiquid projects. Investors rushed in, confident that the FSLIC would bail out bad loans, which proved to be the case in the mid-1980's, when a liquidity crisis engulfed the industry. The government bailed out bankrupt institutions at taxpayers' expense. It was the combination of high-risk projects, no-risk investing, and the lure of above-market returns that led to the S&L debacle.

Another feature of that act passed by almost unnoticed by the public. It authorized the Federal Reserve System to buy assets other than government debt. This has enabled the FED to use its assets legally to support markets. There has been no restriction on the FED if it wants to buy financial futures with newly created money. If there is a fall in the market, the FED can intervene. The leverage is tremendous. It does not have to buy the underlying assets. It can buy a futures contract with a minimal performance bond. Who can afford to bet against an agency that can pay off by creating money?

So, we are now seeing the results of high-risk projects (the Internet bubble), low-risk investing (buying in a market that will not be allowed to fall), and historically unprecedented stock market returns (19% per annum compounded, 1981-99). This has gone on for so long that people have lost their fear of sustained downward moves. This perception of low risk has led to **bubble.com**: the mania of the last three years.

We know what happens when risk is removed by the government: investors put their money into ever-more risky projects in search of above-market returns. This misallocates capital on a grand scale. People lose interest in investing in bread-and-butter businesses. If the stock market will not be allowed to fall very far, why be content with conventional returns in unglamorous companies and industries? Yes, there are mutual funds that invest in such industries, but for the past two years, the performance of the typical stock has been negative or slow. The market indexes are being driven by the high-tech stocks. People know this. They know that the economy cannot grow by 19% per year, let alone 40%. Yet the mania is driving up a segment of the market, which creates the illusion of a boom. So, Americans save less money. The net savings rate is negative. Why worry? The market will make us all rich!

Words of Caution from Warren Buffett

When it comes to stock market investing, Warren Buffett is the acknowledged master. The multibillionaire has beaten the stock market for decades, thereby becoming an urban myth for economists, who speculate (intellectually) that no one can consistently beat the market, year after year.

Buffett's father was Howard Buffett, the congressman from Omaha whose voting record resembled Ron Paul's in our day -- a libertarian. Leonard Read of the Foundation for Economic Education once spoke of Howard Buffett in his most glowing phrase: "He didn't leak." Buffett voted his principles every time. While his son does not share his father's ideology, he is known for speaking his mind without waffling.

Fortune, in its November 22 issue, presented a five-part "distillation" of two of Buffett's speeches, given to friends, beginning in mid-1999. Buffett reviewed it and added clarifications. Because of copyright restrictions, I cannot reprint it here, but I think it will help us all if I summarize the distillation.

Buffett began with an observation: the Dow Jones Industrial Average's 17-year move from December 31, 1964 to December 31, 1981:

12/31/64: 874.12
12/31/81: 875

He commented: "Now, I'm known as a long-term investor and a patient guy, but that is not my idea of a big move."

(Note: this figure is worse than it looks. In between 1964 and 1981 was the worst peacetime inflation in U.S. history. The investor was way down in terms of purchasing power in 1981 -- at least 60%. If he had invested in income-producing rental homes at mortgage rates available from 1964-77, he would have been far better off.)

In the same period, Buffett pointed out, the Gross Domestic Product rose 370%. The underlying productivity of the nation was heading up, yet the stock market had gone nowhere, as of late 1981. Why not? One answer, he says, was rising interest rates.

The economy in late 1981 was in a recession. Interest rates from late 1979, when Paul Volcker took over as Chairman of the Federal Reserve Board, had risen faster than in any other period in modern U.S. economic history. (Volcker had been persuaded by the Board to stop the expansion of money and allow rates to rise.)

Still, the Dow had not gone much above 1,000 during the entire period. Long-term stagnation was basic to the Dow's performance under the high marginal income tax rates of the Johnson-Nixon-Ford-Carter era. Buffett did not mention this factor. He did mention a second major factor, in his view: after-tax corporate profits as a percentage of the GDP.

Investing in U.S. 30-year bonds and reinvesting the interest payments, late 1981 to late 1998, would have gained you a 13% annualized return (pre-taxes, of course). Buying the Dow and reinvesting dividends in the same period would have gained you 19% (again, pre-tax -- and, I assume, counting stock splits). This 17-year increase is the highest in history, even exceeding the return if you had invested at the bottom of the market on July 8, 1932.

Buffett sees the great boom in terms of the downward move in interest rates and the upward move of corporate profits from 3.5% (1981) to the 6% range. By late 1998, long-term rates on U.S. bonds were in the 5% range. The boost from these two factors established the underlying basis of the more than 10-fold increase in the Dow, he says. (It was 13-fold by late 1999). Meanwhile, the economy grew less than it had, 1964-81.

To this was added market psychology. The crowd eventually came to believe that being out of the stock market is a terrible mistake. Buffett said (approximately):

Like Pavlov's dog, these "investors" learn that when the bell rings -- in this case, the New York Stock Exchange at 9:30 a.m. -- they get fed. Through this daily reinforcement, they become convinced that there is a God and that He wants them to get rich.

A Paine Webber/Gallup survey last July revealed that investors with less than five years' experience in the stock market expected a return of 22.6% over the next decade. As I figure this, that would mean a Dow of over 88,000. ($72 \div 22.6 = 3.19$, i.e., the Dow will double every 3.19 years.) Those with more than 20 years' experience expected 12.9% compound growth.

Buffett says this is not going to happen. Why not? Because interest rates are not going to fall that much, and corporate profitability in relation to GDP will not rise sufficiently. Corporate profits are now at the high end of the scale by historic standards. Politics will not allow them to get much higher, nor will competition. Interest rates are low compared to 1981.

What about economic growth? If we have 5% nominal growth, with 2% price inflation, that would be very good. He thinks that such growth is at the high end of the possibilities. So, the underlying engine of profitability is already in the optimistic end of the bell-shaped curve.

Some company managers will buy back outstanding shares with company profits. That raises share prices. But other companies will be issuing new shares. Then there are companies that reward employees with stock options

rather than money. (Note: Microsoft is the leading example, although Buffett did not mention this.) Conclusion:

So I come back to my postulation of 5% growth in GDP and remind you that it is a limiting factor in the returns that you're going to get: You cannot expect to forever realize a 12% annual increase -- much less 22% -- in the valuation of American business if its profitability is growing only at 5%. The inescapable fact is that the value of an asset, whatever its character, cannot over the long term grow faster than its earnings do.

Buffett pointed out that in 1998, Fortune 500 companies had \$334 billion in profits. The market valuation of the companies was \$10 trillion, or about 40 times higher than profits. (Note: profits must pay for future growth, not just today's dividends.)

Then there are transaction fees for buying and selling. Buffett estimates that these costs are over \$100 billion a year, or maybe \$130 billion. The \$100 billion would then apply to the Fortune 500 firms. Take this away from the \$334 billion in profits. So, investors are reaping about \$250 billion on their \$10 trillion investment. He calls this slim pickings.

What, then, can we expect? He thinks we may see 6% GDP growth per year, with 2% of this price inflation. That is, 4% real growth. It could as easily be lower as higher.

So, how will the market sustain 12% or 19% or 22.6% growth? It won't. Forget about it.

But what if you pick a winner? It's not easy. Even if you pick a hot industry, you can lose. Consider the auto industry and the aviation industry. There have been 70 U.S. firms producing cars in the U.S. in this century. Today, there are three U.S. firms. The auto industry changed America, but you can't tell this from the return on "buy and hold." There were 300 aircraft companies in the U.S., 1919-39. Boeing and a few others remain. Also, 129 airlines have filed for bankruptcy. "As of 1992, in fact -- though the picture would have improved since then -- the money that had been made since the dawn of aviation by all of this country's airline companies was zero."

He thinks that American industry will plug along, increasing its profits by 3% annually in real, noninflationary terms. He thinks the long-term investor will do all right. But over the next 17-year period, investors will enter an era in which stock market investing will become less euphoric.

This is Buffett's traditional buffet: meat and potatoes. He is not a random-walk advocate. He does not tell people to buy an index mutual fund with low fees and hold it. He does not tell them to put 50% into the index fund and 50% into a long-term U.S. bond fund and then reallocate every January to achieve 50% -- Scott Burns' couch potato investment portfolio. He goes for value, i.e., companies that are well run. But no one else whom anyone has heard has matched Buffett's record for picking such companies.

Is his warning correct? Do you want to bet that the greatest stock market investor in history is wrong? Is there any factor in the economic pie that could change his scenario? He asks people to suggest something. The main

factor I think of is the impact of income tax-deferred retirement funds: "buy and hold." But these assets will start being liquidated sometime in the middle of the next decade: 2005-6. The retirement years of the baby boomers will begin. The flow of investment funds will slow and then reverse. Besides, investors can switch to bonds or short-term money market instruments in these funds. The issue of return on investment is always with us.

The stock market optimism of the last 18 years will not be sustained.

Rising Expectations Will Be Thwarted

We have had an economy with no recession for seven years. The investment world has not had a boom like this for a long time. Superimpose this on top of the 18-year stock market boom, and we find a new mentality. It is the same old mentality that appears at the end of any boom. It's the mentality of the Japanese investor in late 1989, when the Nikkei index was over 39,000. The world of profitable investing could not reverse. This was a boom for all seasons. It ended in early 1990 and has never come close to returning.

This is not understood by seasoned investors today. Buffett is correct: this stock market boom cannot continue. The question is: Are institutional constraints such that a depression is impossible today?

On the surface, this appears to be the case, as long as the FED is ready to inflate. But there is still the problem of cascading cross defaults. The FED is only one institution. The market is much more powerful. Greenspan's justification to Congress for gathering together the big U.S. banks to lend an additional \$3.5 billion to Long Term Capital Management Ltd. in August of 1998 was that the financial world faced an imminent crisis. Here was a hedge fund that most people had never heard of, yet its failure was threatening the ability of major financial institutions to settle accounts with each other.

Public optimism is high today. Savings in the U.S. are now negative. Those people who normally provide savings are looking at their stock market portfolios and saying to themselves, "I don't need to save. The stock market is doing it for me. My net worth increases 20% per year. All I have to do is sit back and get rich." This is the problem with rising expectations. These expectations persuade people to alter the practices that have produced wealth for capitalist nations.

Consumer confidence is at an all-time high. People are convinced that this economy is invulnerable. When the general stock market drops, they pay little attention. It will not fall further, they assume, or not enough to force them to consider a reallocation of their assets. They go more deeply into debt. They see their increase in net worth on paper as justifying the increase in their actual obligations.

But debt must be serviced, with or without rising net worth. A portfolio's value is the product of market imputation: the most recent price of a single asset times the total number of shares outstanding. Debt is different. It is a legal obligation. It is a meter that must be fed, whether or not a portfolio is up or down. Debt has a binding reality that a portfolio does not. It has a grim permanence.

I think one factor that Buffett ignored in his discussion of the 1981-1998 increase in the U.S. stock market is the effect of the Monetary Control Act of 1980. When the FED was authorized to buy any asset for inclusion in the monetary base, it was thereby authorized to be the buyer of last resort. It had always been that for U.S. government debt. Indeed, the justification of all central banking ever since the Bank of England was created in 1694 was this: to be a lender of last resort for the central-bank-licensing national government. But the new law moved the central bank from the lender of last resort to the buyer of last resort.

This position has made the FED the securer of market optimism. The FED has the ability to use the futures market to provide a floor. This seems to have taken the risk out of the market. The optimism today is overwhelming. People believe that the system will not place them at risk.

But the FED has to be careful. It cannot appear publicly as a manipulator of the stock market. It does not make such futures purchases openly. The belief is that it does, but the paper trail is never pursued this far. Investors know that the FED can do it, and there are telltale signs that it has, but nothing is said about the implications, namely, that if the FED goes long, it has to buy the underlying asset if the contract expires. If the FED cannot sell the contract into a rising market -- rising because it has intervened -- then it has to inflate. This will raise interest rates: the inflation premium in any loan. That is bad for the stock market. The FED cannot intervene sufficiently in a truly panic-driven market. It can keep things from collapsing only up to a point. Beyond this point, its intervention will be seen as destructive to the currency.

The 18 years of market boom, interrupted only in 1987 and 1992, has taught investors that the sky is the limit, and the FED and the pension fund inflows will secure the floor. This has produced an optimism like no other in U.S. financial history. But the economic fundamentals can no longer sustain this optimism. This is Buffett's clear warning.

What will people do when the market ceases to provide such growth? If there is no recession, then there need be no stock market bust. That is, if the new paradigm is really true, then we will move from thwarted expectations to Buffett-like expectations without any significant fall in the market. But how can this happen? It has not happened in past booms. Letting the air out of a financial bubble has always led to pops, not slow growth. The reason why people hold bonds and CD's today is because they want to secure 6% or 7% returns with little risk. If the stock market falls back to 5% or 6% returns, as Buffett forecasts, why would investors own so many stocks? There is some risk, after all. Why not shift to income-securing assets?

The point is, people will not believe that the stock market will produce 6% until it falls 30% or more. They will not abandon their faith unless they lose big in the market. When well-seasoned investors today expect 12%, then it will take a major market correction to move them out of equities and into the credit markets. They will then see the reality of debt: debtors keep paying (usually) even though stock portfolios are falling. The logic of extending credit will occur to them when their stock portfolios are falling.

Otherwise, if it's 6% per annum total return from stocks, with a price floor secured by institutions, there is no strong case for becoming a creditor.

Why loan money at a fixed return if you can be almost certain of 6% in stocks, and favorable capital gains tax treatment?

Companies and home buyers want access to credit. They do not fund everything with sales of stock. For the credit markets to compete with a stock market that is expected to pay 12% per annum and taxed at capital gains rates, there has to be risk in stocks. The risk is that the stock market will get hit at some point. The proof that the stock market is vulnerable is the fact that there is still 30-year money under 7% for the U.S. government.

The illusion of a low-risk U.S. stock market has not become so pervasive that millions of investors want into this market. But Buffett thinks that rates will not go much lower. Yet low rates have prevailed. Somebody is lending. There are still millions of investors who are trying to secure their futures by extending short-term credit. I think they are wise.

I don't think Alan Greenspan sees his role as that of a distorter of markets. But he has kept this system going since 1987. He came into office a few days before the October crash. He told the investment world on the day of the 508-point drop that the FED would provide liquidity. But, generally, he is not one to make policy for the benefit of stock brokers. He has said that the FED will raise rates. More important, the FED is now shrinking the money supply. The 39% increase in the FED's balance sheet in the final 3 months of 1999 is now being reversed. This is a presidential election year, but the money supply is shrinking. This is abnormal. That's because Y2K was abnormal.

The FED will not act to sustain the stock market boom this year. Greenspan is not willing to inflate the currency just to keep the 19% per annum return alive for the stock market. He is not impressed with bubbles, as he has said repeatedly. He will do his best to keep a financial panic from taking place, but he is not enthusiastic about a stock market boom that is being driven by unrealistic expectations -- what Buffett calls Tinker Bell analysis: "Clap if you believe."

I suspect that most stock market investors today are so convinced that this market cannot fall for more than a few weeks that it will take a significant sell-off to break the steady move into stocks. The fact that most stocks are down over the last 18 months has not penetrated the thinking of investors. The NASDAQ index is up. The Dow index has not suffered a permanent setback. The high flyers keep pulling up the averages. The bad news for conventional stocks is hidden. But the reality is that most investors are no longer being blessed by automatic growth. They have been taught to be patient by a philosophy that says the stock market will go up, long-term, no matter what. This faith has sustained the boom far beyond what rational expectations regarding future returns would allow. That's why Buffett's realism is a threat to straight-line, sustained market growth. When the reality of what he predicts hits investors, they will begin to reallocate their portfolios. "Sell!" Those who reallocate earlier will be the winners.

Greenspan is anti-inflation. We must recognize this if we are to plan for the future. John Mauldin writes of Greenspan:

He expanded the money supply at 19% for the last quarter, which added a lot of fuel to an already overheated stock market -- people poured money into blue chips and technology stocks. He tried

raising rates three times to compensate, and just about everybody acknowledges that two or three more interest rate hikes are right around the corner. But even the smartest economist or Federal Reserve Chairman in the world may not be able to stop the disastrous consequences of that.

The Fed has a tendency to keep raising rates and tightening the money supply until something happens, which is usually either a slowdown and a serious stock market drop or a recession and an even bigger market drop. The trick, which Greenspan has been good at, is to engineer soft landings like he did in the 90's. But he has never had to do it from such a bloated money supply and an irrationally high, over-exuberant stock market. . . .

Now we have a situation where the market cap of Microsoft is nearly that of the entire US Treasury Bond market. . . .

~~But you cannot create wealth just by trading pieces of paper called~~ stocks and pumping up their price. You can create the illusion of wealth. But at the end of the day, someone's got to provide goods and services that create real, per-share earnings for the company. And a lot of these high flyers will never be able to earn enough to justify their stock prices. . . .

Most net companies won't ever see earnings. Finance Professor Howard Simons points out Yahoo! will have to grow its earnings at a rate of 56%, more than the 43% even lofty Microsoft has done, for the next ten years to come close to justifying the price it commands today. And Microsoft has a dominant market position. (I won't say monopoly.) Yahoo! has more competitors than Carter has pills. Yahoo! won't grow at 56% a year for ten years. Won't happen. Not possible. Book it. . . .

I am sorry, but price to sales or price to future potential sales or price as compared to the price of tea in China is not a logical methodology. Last I looked, it takes profits to keep the doors open. . . .

~~A very famous man once said, "Once stock prices reach the point at~~ which it is hard to value them by any logical methodology, stocks will be bought as they were in the late 1920s -- not for investment, but to be unloaded at a still higher price. The ensuing break could be disastrous because panic psychology cannot be similarly altered or reversed by easy-money policies."

Who you ask, was that pearl of wisdom from? Alan Greenspan in a *Fortune Magazine* interview in 1959.

Tight money will produce rising short-term interest rates. Beware the inverted yield curve, when 90-day T-bills command a higher rate than 30-year U.S. bonds. This is a classic indicator of recession. It's not here yet, but 10-year bonds rates have moved higher than 30-year rates. To "fight the tape" of the stock indexes is risky, but the general movement of conventional stocks is down. There will be a rebound of the conventional stocks to match the **bubble.com** stocks, or a fall in the latter. I think the bubble will burst.