# The robust Dow Jones: A closer look at the 'fantasy index'

by John Hoefle

*John Hoefle, of the* EIR *Economics desk, gave the following report to the* EIR *seminar on "How to Save the Economy," in Washington, D.C. on July 23.*

Actually, what we'll start with is an Economics IQ Test (**Figure 1**). This is the Dow Jones Industrial Average, since 1900. Now, if you look at this and think, "Oh my gawd, we're in trouble!"—then you pass. If you look at this and say to yourself, "Oh boy! We're rich!"—well, then you're an expert. And you're qualified to be an investor, a stockbroker, or a financial writer for the *Washington Post*.

The *Washington Post,* of course, is the newspaper that periodically reminds its readers that the major danger in the U.S. economy today, is that the economy is growing so fast, it can overheat—and that can lead to inflation. So, you know right away, that they're insane.

But, if you look at the Great Depression, you had a stock market drop in two days, of about 25%. That was in the neighborhood of about 60 points. In 1987, the great crash of about 23%, was 500 points. Now, all the experts will tell you: That's all history; we've left that all behind, and there's your empirical evidence—that we've left it all behind.

The stock market, since 1987, back when we were warning people to get out, and when Lyndon LaRouche predicted that there would be a crash: It has quadrupled; since 1995, it's doubled. Today, if we had a crash, equivalent to the 1987 crash, it would be about 1,800 points.

Now, you look at this curve, and the way the stock market is going up: Here's a nice hyperbolic curve. Now, think about the Triple Curve [see **Figure 1,** p. 23]. While this has been going up, the real economy has been going down. The real economy has collapsed at about 50% since 1970, at the same time that this has skyrocketed. So, what you're dealing with is not a measurement of anything real. What you're dealing with here, is what you might call a fantasy index. It's a tool for brainwashing the population. Everybody talks about the Dow Jones—this is what the big economic measure is. "The economy doin' OK? The Dow go up? Oh, it fell back a little bit, maybe we're not doing so good." None of it means anything.

It's also a reflection of the biggest financial bubble in history. This (**Figure 2**) is the same thing, but from a slightly

FIGURE 1
**Dow Jones Industrial Average**

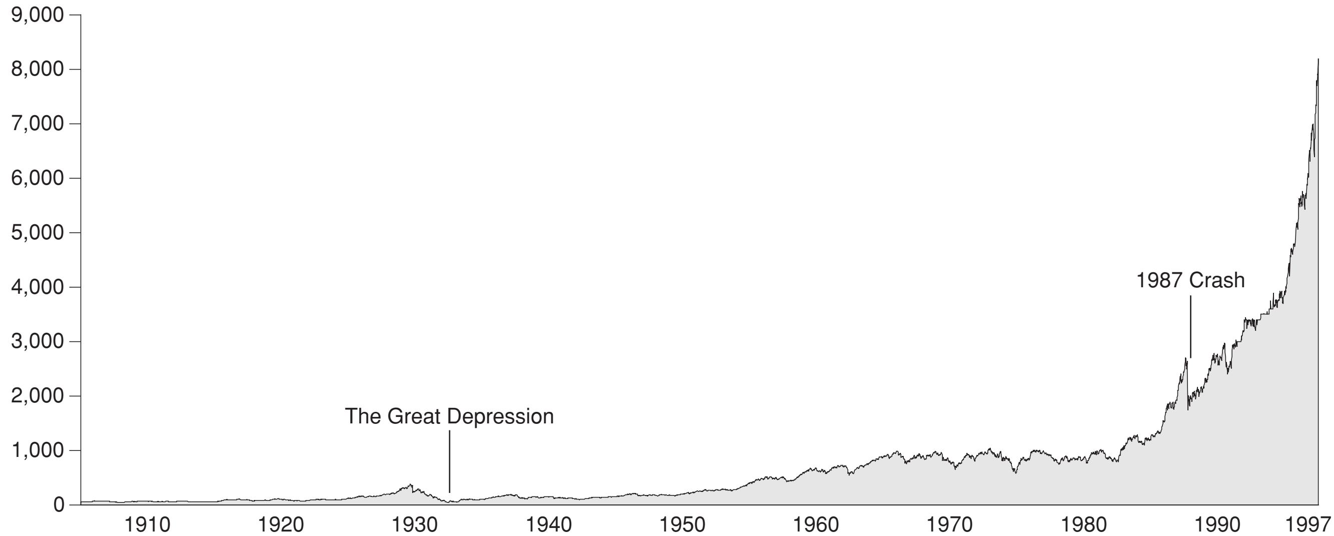


FIGURE 2
**Number of years it has taken the Dow Jones to rise to the next multiple of 1,000**

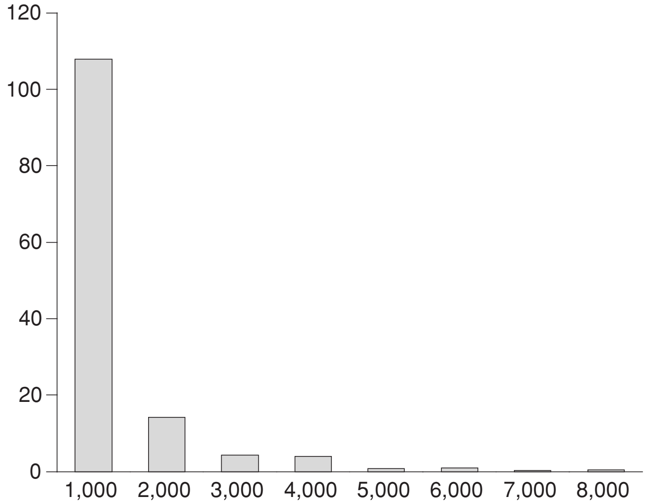



FIGURE 3
**Capitalization value of all stocks traded on U.S. stock markets, 1950-97**
(trillions $)

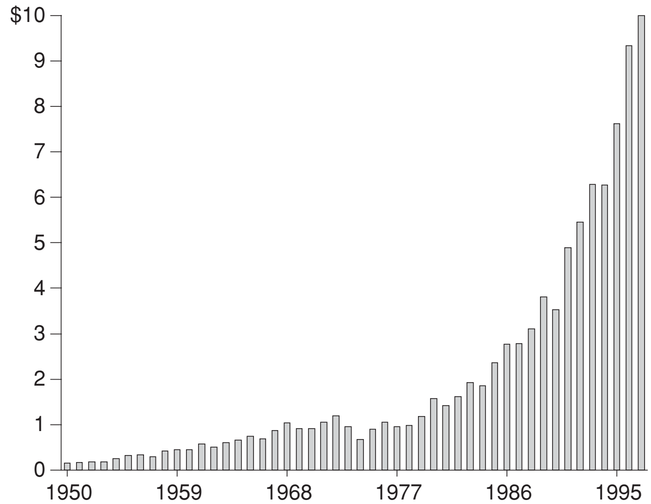
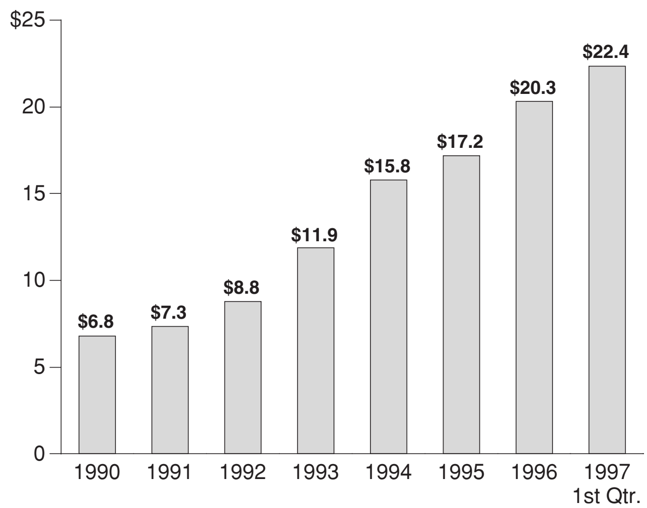



FIGURE 4
**U.S. banks' derivatives holdings: FDIC 'off-balance-sheet derivatives'**
(trillions $ at year-end)




Source: FDIC.

different perspective. This is how long it takes to rise 1,000 points. From its inception, it took over 100 years to break 1,000. To break 2,000, it was 14 years. Three thousand and 4,000 took about four years apiece. And then, when we have the *real* economic recovery, we switch to days—now it's a matter of a few hundred days, to break thousand-point barriers. So, our hyperbolic curve is picking up steam.

## A bubble bigger than the GNP

Now, while the market is going up, the market capitalization, which is the values of all of the shares of stock, has gone way up, to about $10 trillion, which is bigger than the GNP of about $8 trillion (**Figure 3**). And you can see it's risen nicely over the last few years. Back in 1990, the market capitalization was about $3.5 trillion. Today, it's $10 trillion. So, while a 10% correction of the stock market wouldn't drop it to anywhere near what it was at, say, the time of the 1987 crash, it would still wipe out about $1 trillion of value. Since the experts are saying that we might have a 20% correction on the stock market, they're talking about wiping out a couple of trillion dollars of value. That's mostly paper money; it doesn't really exist. But, of course, if part of that money is yours, and you have to come up with something to cover it, you might see it slightly differently.

What's behind all of this? The Dow is a reflection of a financial bubble. One of the best elements of this bubble is derivatives. What's a derivative? A derivative is basically an IOU: It doesn't exist. It's a bet. You bet that something's going to go one way; somebody else bets it's going to go another way. And, it's like a casino; it's much more like a casino than a financial instrument.

So, derivatives are now—we estimate—at about $100 trillion a year, outstanding, worldwide. And turnover, which is the number of times these things are bought and sold during the year, is probably well over *a quadrillion dollars* a year. Now, remember, all this grows, while the real economy, which is responsible for *paying* for this stuff, is declining.

So, this is unsustainable.

Now we'll get to the U.S. banks (**Figure 4**). The U.S.

FIGURE 5
**U.S. banks addicted to derivatives: derivatives versus assets, loans, and equity**
(trillions $)

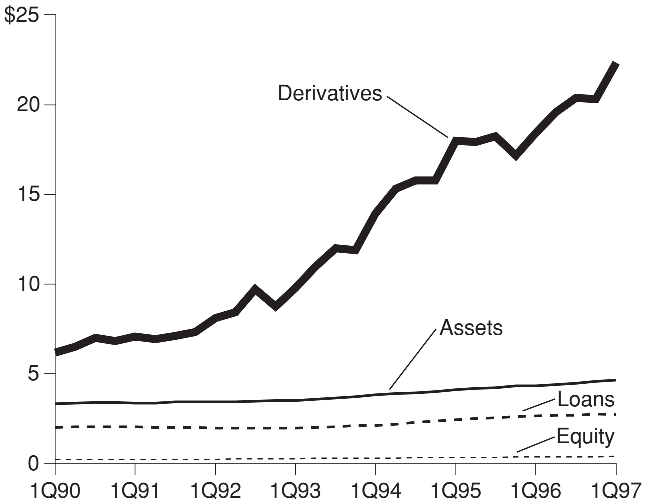



FIGURE 6
**Bankers Trust New York Corp., 1994**

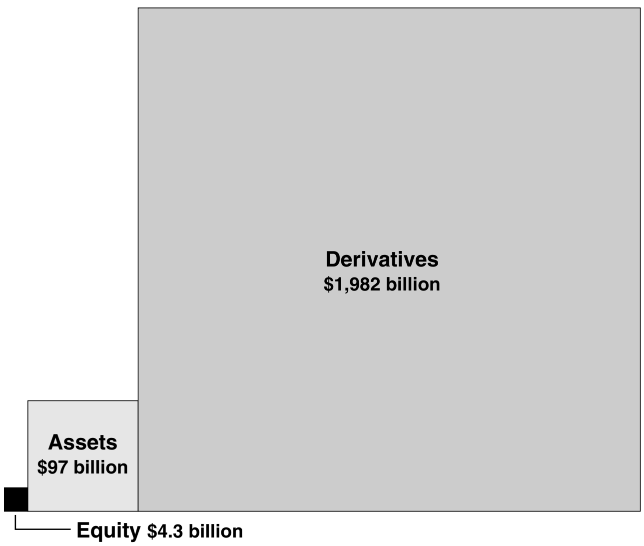



FIGURE 7
**Consumer credit**
(trillions $ outstanding)

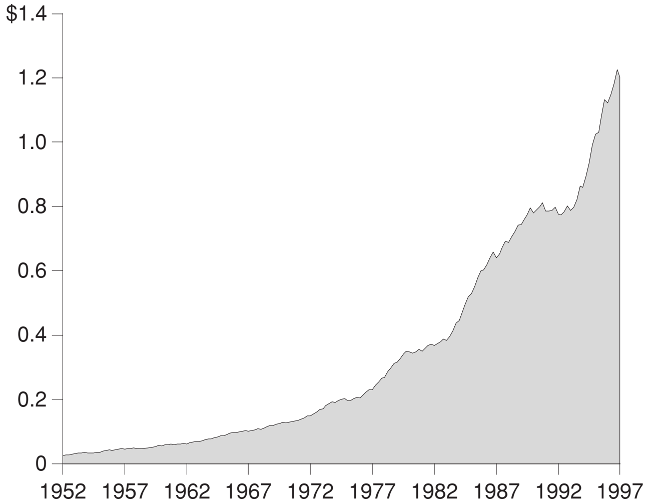
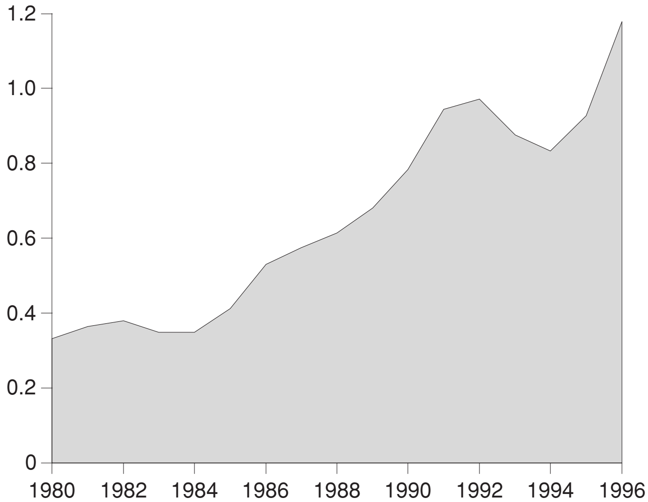



FIGURE 8
**U.S. bankruptcy filings**
(millions of filings)




banks now hold about—as of the first quarter—$22.4 trillion in what the FDIC calls "off-balance-sheet derivatives"—now, that's against about $4.5 trillion in assets; so, the derivatives are five times the assets—and about $300 billion in equity, which is the net worth of the banking system itself.

Now, here (**Figure 5**), the top line is the growth of derivatives. Then you've three lines that are pretty flat, down at the bottom. The top line [of those three] is assets, the middle line is loans, and the line that runs right along the bottom, that's the equity. So, here you have a banking system in which the parasite is rapidly taking over. They're not banks anymore: They're speculators. This has become a casino, rather than a banking system.

To take an example: Here's Banker's Trust (**Figure 6**); this is 1994, which is a significant year for Banker's Trust, because that's the year that the Federal government stepped in and took it over. And you can see why they had to step in and take it over. The little, bitty black square—the thing that looks kind of like a smudge—that's the equity of Banker's Trust, it's about $4 billion. The second square is their assets, of about $97 billion. And the really nice, big one: That's their derivatives portfolio.

If you look at that, you see that the derivatives—they're not carrying on the balance sheet; they're, again, off-balance-sheet derivatives. So, when you look at the balance sheet of any bank, basically, it doesn't mean anything, anymore. If you've got something this huge, that's hidden, you're not dealing with reality, when you talk about the balance sheet.

Another way to look at this, is to think of a dog with a one-thousand-pound flea on it. You can see that both the dog and the flea have a real problem: The dog has a problem, because the flea is sucking it dry. The flea has a problem, because it's killing the dog. And there's you're banking crisis, and there's your financial crisis, in a nutshell.

Now, to compensate, we've had this 50% collapse in productivity and output, and basically, in the standard of living. It used to be that a father could support a wife and two or three kids on one income. Now, everybody in the family is working—and they're not doing as well as it used to be on one income. We have an income shortfall: People aren't making enough money. To make up for it, they've been borrowing like crazy (**Figure 7**). Some people are even borrowing to buy stocks. Now, that's really smart! As one of our political prisoners reported to me the other day, there are people who are now in jail, because they were out stealing; and they were taking the money that they got from stealing and they would put it in the stock market. That's really nice: Here you have small-time crooks, stealing from people, to turn their money over to the biggest crooks in the world!

Another impact of this is, in bankruptcy filings (**Figure 8**): Because the danger here, is not just that there's a big crash coming. The *real* problem is, also, that the very existence of this system is killing people, just like the fleas are killing the dog. Money that should go into infrastructure; money that should go into education; money that should go into all of the things that people need to survive; money that should go into decent wages, is all being sucked away, and fed into this financial bubble to keep the system afloat.

But, the system can't survive.

So, that's where we stand. So, when someone says to you, "Hurray!" The Dow Jones is now—what?—10,000 by the end of the day. Maybe 100,000 by year-end (of course, unless it collapses)—you never know how fast it's going to rise, but you know one thing for sure: It's not going to keep going up. When someone starts talking about the market, give them the Economics IQ Test. See if that causes them to think. And, when you read the *Washington Post,* the best response is to just laugh at them.