# III. International

# U.S. Stock Market Valuation Is Fed by Unprecedented Leverage

by Richard Freeman

Jan. 13—The market capitalization of stocks traded on the major U.S. stock market surged to $51.8 trillion as of early December 2021, an unprecedented level in the history of those markets. On Jan. 1, 2020, the market valuation of all U.S. stocks—traded on the New York Stock Exchange, the American Stock Exchange, and so forth—stood at $33.9 trillion; on Jan 1, 2021, it stood at $40.7 trillion; and by December of that year, it reached the $51.8 trillion mark. Thus these "values" have increased by 52% in less than two years, during which the U.S. real economy fell into deep recession and has not yet recovered its previous levels of employment, industrial production, or manufacturing output.

Despite the endless media stories about shrewd trading strategies, "Robin Hood investing" and similar legends, this tremendous growth has been powered by multiples of leveraged loans; that is, it is a debt bubble. A margin loan from a bank or dealer allows an investor to buy a much larger stock investment portfolio than he could buy just using his own cash, and consequently to take on high-risk debt. The collapse and liquidation of the big Archegos hedge fund in the Summer of 2021 demonstrated just how high-risk such margin stock buying can be both to the borrower and the lender. The value of outstanding margin loans to investors in the U.S. stock markets rose from $561 billion in March 2020 to $918 billion today, an increase of 64% in just 21 months.

## 'Reverse Leverage' Coming

In addition, there are other forms of highly leveraged investments in the stock markets: The Standard and Poor's 500 Futures, based on an index of 500 stocks traded on the Chicago Mercantile Exchange (CME), are *derivatives*, through which one speculates on the stock market without buying stocks. Back in the 1920s these were called "bucket shop" purchases and were outlawed in New York and a number of other states. Trillions of dollars are invested annually in the S&P 500 index and related stock futures and options.

Using such futures, banks and investors can deliberately raise or lower the stock market, called "updrafting" and "down-drafting." Hedge funds, private equity funds, and banks feed this leverage orgy. But the effect doesn't end there. One can use the fictitious valuation of an inflated stock to secure personal loans with which one can buy all sorts of consumer goods.

The stock bubble has infiltrated into the pores of the U.S. economy. In a 2020 Harris poll survey, 43% of retail, individual stock investors responded that they were using margin loans, options, or both.

How large is the U.S. stock bubble and what will its deleveraging consequences be? To put it into perspective: in 1929, the market capitalization of the stock markets totaled $8 billion, and when the debt leverage went into reverse (demands for immediate collection) starting in late 1929, the New York Stock Market lost 89.2% of its total valuation. Today's leveraged stock market valuation is roughly 6,500 times greater at $51.8 trillion. The American economy's GDP, however, is just 200 times greater than in 1929.

There are other parts of the "everything bubble." In the third quarter of 2021, the total debt outstanding in the U.S. soared to $63.7 trillion (including government, corporate and household debt), three times its level of just two decades ago at the start of this century. In addition, the value of mortgage-backed securities reached $11.9 trillion. The value of derivatives held by U.S. financial institutions reached $185 trillion (the real amount is actually higher).

And the American physical economy, as partly indicated above, has been in a process of stagnation since 2010 and overall contraction since 2018.