The stock markets are about to undergo shock treatment

A guest contribution from Uwe Günther

All stock market crashes in history have been based on excessive and unproductive borrowing and lending. The writing on the wall still points towards turbulence. Stock market crashes are debt crashes!

It is true, ignoring technological progress, that there can be no economic growth without borrowing. But we must distinguish between "productive" borrowing, which results in higher demand in the real economy, such as for cars or houses, and unproductive borrowing, which primarily inflates the financial markets. Unfortunately, the latter is occurring at the moment. In the past, such constellations have - invariably! - led to stock market crashes sooner or later. It is unlikely that this would be any different this time round. From our perspective, there are eight reasons which clearly show that we will experience further severe corrections in the foreseeable future. These are the details:

1. The broad US stock market is traded at record levels. The S&P 500, which comprises the biggest listed US companies, is significantly higher than in 2000 and 2007. At the same time, many stock market heavyweights are far below their top prices. In other words, the index view greatly distorts the current situation.

   Back then, what followed was the TMT crash of the century (2000-2003) and the global economic and financial crisis with the second largest stock market crash in the last decade (2007-2009). Shortly before the stock markets collapsed at the time, the volume of shares bought on borrowed funds had increased exponentially in the USA. Today, debts for share purchases amount to around USD 500 billion. Approx. 20 percent more than before the last two major crashes.

2. Corporate share repurchases are enjoying a boom - especially in the USA. And these are also largely financed by loans. Instead of investing, and as such increasing group profits, companies are reducing the number of shares in circulation. Even where companies do not actually generate higher earnings, this increases earnings per share - because profits are split between fewer shares. No more than a parlour trick. At the same time, scores of managers are ridding themselves off their share options "on the back of" their companies' borrowings and are cashing up.

3. The medicine prescribed by the federal banks no longer works. The extremely low interest rates and high liquidity are merely resulting in a shift of debts from corporate to federal banks but are failing to trigger any additional investments in the real economy. This is because companies will only expand if they can expect higher demand. Even in Germany, the investment ratio is stagnating at currently 19.3 percent. It is much too low for additional growth impulses.

4. The monetary policy of the ECB, FED and others in recent years has led to extreme differences in income. The rally on the financial markets initiated by the federal banks has made the wealthy even richer - by contrast, large groups of the population lost interest income on their savings. The super-rich are particularly well-sated - their consumption is comparatively low and in addition, their wealth is largely unproductive socially speaking. Simultaneously, higher and higher proportions of the former middle classes in nearly all industrialised countries are ceasing to be productive consumers.

5. The United States - the largest economy in the world - is dramatically losing human and economic resource substance. Nearly 50 million Americans live on food ration cards. The country's transfer payments are increasing dramatically. The wage proportion of the total gross domestic product is at a record low. Nevertheless, Americans are (still) consuming more than ever before. The gap is financed by additional debts. Student, car and credit card loans are racing from record to record. The USA is currently consuming its future.

6. In spite of this, companies are making record-level profits. However, especially in Europe, these are largely based on the extremely low interest rates in the financial environment distorted by the ECB. This level can only be maintained for even a short time in the future if the federal bank basically pays out money using negative refinancing rates. In the USA, the mentioned share repurchasing programmes are added to this.

7. No, or even negative, earnings can be expected for European and American shares in the coming years both in terms of the book value and in historic comparisons. This also increases the risk of an impending stock market crash (http://www.teleboerse.de/anleihen/Anleger-im-Taka-Tuka-Land-article15208566.html).

8. Major investors who think strategically, i.e. so-called smart money, are currently reducing their risk items at a dramatic speed and are using this phenomenal opportunity to remove "chips from the table". This "hot potato" is then passed on to companies (see share repurchases) and private investors. Not a good sign.

Anyone not afraid to take an honest look at their assets should ask themselves how sustainable their perceived wealth as currently shown on their portfolio statement really is. The next debt crash will happen and will separate debt funds from substance like a magnet. It will reveal the real substance value of property, shares or classic cares, which can then be acquired at this level or even below it. A pleasant side effect: If you build up cash in advance (like the smart guys), you are more likely to receive more in your portfolio later on. We are definitely on board!

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