

By John Wyn-Evans
Head of Market Analysis

Echoes

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The US economy is prone to booms and busts, but we believe it's too early in this new technology cycle to call the top of the market.

I am writing this Weekly Digest on 19 October. Many of you will remember that as the date of the stock market crash of 1987, although for many in the UK the 'Great Storm', three days earlier, might well have had a greater impact.

My memories of those days remain clear. I was working in New York as an equity salesman at the time, so was close to the epicentre of the crisis. On the Friday afternoon, I had been at a meeting with one of our analysts and a client, discussing the hot topic of the forthcoming UK utility privatisation programme.

Out of the corner of my eye, I could see the blinking green numbers on the (what would now seem primordial) Reuters news and price terminal. I could see the Dow Jones Industrial Average falling fast. When the drop went above a hundred points, I interrupted the people in the room who

Quick take:

- The Federal Reserve has a history of intervening to support financial markets.
- This can encourage excessive risk-taking.
- We travel as far back as 1873 in search of lessons.

were actually working to suggest they take this in.

That drop might not sound a lot for an index that today has a value of almost 52,000, but on Thursday 15 October it had closed at 2,355, so the eventual decline of 108 points amounted to 4.6%.

This was the first time in history that this flagship index had fallen by more than a hundred points in a single day.

Work stopped. There was a sense of foreboding in the air. The weekend was filled with speculation about what would happen on Monday.

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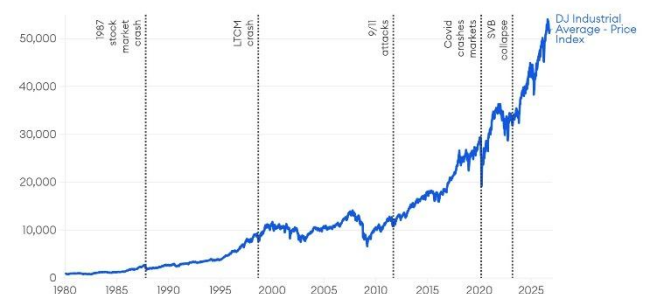
Crash

My first engagement with the day of the crash was when I arrived at the office at around 6.30 am, New York time. In those days, there was no means of knowing what had been going on before reaching work, so when I entered the trading room, everyone who was already there challenged me to guess how much the FTSE 100 index had fallen already. Because of the hurricane, it had never opened on the Friday and had closed on the Thursday at 2,301. I ventured a number that might take into account some storm damage-related losses and a bit more for Friday's US decline. How about down 100 points – a bit more than 4%? It all turned into a game similar to 'Play Your Cards Right', the UK show hosted by Bruce Forsyth, as everyone shouted "higher!" at me – meaning that the fall was even bigger. It was, from memory, around 200 points – almost 9%. The FTSE 100 eventually closed around 11% lower, after a volatile day.

Back in the US, the stage was set for a proper crash. The Dow opened exactly 200 points lower. That triggered a wave of further selling, driven by the hitherto relatively unknown phenomenon of 'portfolio insurance'. This was a pretty crude stop-loss strategy, where investors sold stocks once they'd dropped to a certain level. This mechanism fed on itself to force prices lower and lower. The Dow

closed down a gut-wrenching 508 points, or 22.6%.

State intervention has sustained the US stock market at moments of crisis



The FTSE 100 shed another 250 points on the Tuesday, matching the Dow's fall. It didn't find its floor until 10 November. The Dow, on the other hand, got everything out of its system quickly, bottomed out early on the Tuesday morning, and then rallied. This was largely thanks to the intervention of Federal Reserve Chairman Alan Greenspan, who announced that the Fed would provide all the liquidity the market might need and also cut the benchmark Fed Funds rate by 0.5%.

The Fed 'put'

This became known as the 'Greenspan put'. Investors can buy put options, giving them the right to sell stocks at a predetermined price, regardless of how far the market has fallen. Because Greenspan was limiting investors' losses through Fed

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support, it was as if he'd given all investors put options – hence the name.

The Greenspan put appeared again in 1998, when the hedge fund Long-Term Capital Management (LTCM) went bust, and once more in the aftermath of the 9/11 terrorist attacks. In all three cases, the low interest rates set by the Fed contributed to excess lending and to speculative behaviour by investors and others, followed by a nasty reversal. There was the Savings & Loans boom and bust of the late 1980s, as well as some unsustainable leveraged buyout activity. The late 1990s saw the final stages of the dotcom boom and bust. And the mid-2000s saw the spectacular rise and fall of the sub-prime mortgage industry, which culminated in the Global Financial Crisis. No doubt others were complicit and there were a lot of bad actors, but one can't help but feel that the rider – Greenspan – had let go of the reins.

The Greenspan put was handed down to his successors as the 'Fed put' and utilised with varying degrees of success. When interest rates were too low to be cut further, Quantitative Easing was introduced. This is when a central bank buys bonds to support economic activity. These purchases tend to push bond prices up, driving longer-term yields and borrowing costs down. After rates rose in 2018, a seizure in the 'repo' market (where banks access money, or 'liquidity') forced

then-Chairman Jerome Powell to cut them again, inventing his own-brand 'Powell pivot'.

Powell went on to provide liquidity when the Covid pandemic smashed markets in March 2020. The failure to apply the brakes again when it might have been appropriate helped fuel the excesses of the 'meme stock' era of 2021, when investors bought shares that had gained a cult-like following on social media, without looking at the usual financial fundamentals that govern rational investment decisions.

This was followed by the bond market crash of 2022, when the price of money had to be aggressively raised because central banks everywhere had fallen behind in the fight against rising inflation even before Russia launched its full-scale invasion of Ukraine.

The Fed also provided a backstop to the banking system in 2023 when Silicon Valley Bank (SVB) and others went under because of the increase in interest rates and bond yields. The government guaranteed all of these banks' deposits, rather than sticking to the usual limit of \$250,000.

This left more speculative investors feeling invulnerable, which was quite a psychological boost as we entered the period of exponential capital spending growth associated with AI.

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1873, 1929, 1987, 2000, 2008... 2026?

A year ago, I was getting many questions about whether the market was going to crash as it did in 1929. That was largely thanks to Andrew Ross Sorkin's book on the subject, 'Too Big To Fail'. I read it and concluded "no". Whatever levels of excess and skullduggery there might be today, they were multiples greater in the late 1920s. Also, crucially, policymakers were not especially astute back then, when it came to responding appropriately.

This year, everyone's going further back in time to 1873, thanks to Liaquat Ahamed's book of that name. It explores what it describes as the "first great depression", centred around another boom-and-bust cycle, in the buildout of the US railway system. As in 1987, when the market collapse was partially blamed on Germany raising interest rates, the seeds might have been sown as far away from the US as Austria, when its government (and some others) switched from a silver to a gold-backed currency. Vienna was a big financial centre at the time. As silver fell in value, various financial foundations cracked, leading to financiers going bust and less capital being available for railway-building – although by now there were already too many railways competing with each other to allow everyone to make a profit. And so here we are today, facing threats of an overbuild of data centres or a drying-up of capital

to support the construction. Neither outcome would be a great one for markets, but they would play out in different ways.

We continue to believe that it's too early in this new technology cycle to make such a definitive 'top' call, but there might be a certain amount of fame to be made if one did. Take Steve Eisman, a real-life character in 'The Big Short', a book (and later a film) about the 2000s US housing bubble by Michael Lewis. Eisman, who correctly called the US sub-prime bust and made his reputation (and a pile of profits) from it, puts it well: "Everyone wants to be me!"

Perhaps the best thing that could happen is if the more speculative projects are held back and we are left with a slower, but ultimately more sustainable, investment cycle. There's plenty more to come on this theme.

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Regional highlights

UK. The recent run of positive UK data continued with GDP and employment. August saw real GDP increase by 0.1% over July, against a consensus forecast of a decline of 0.1%. That came on the heels of consecutive 0.4% monthly gains in June and July. The only conspicuous weak points were construction (owing to higher rates) and some consumer services (a hangover after high spending for the June-July World Cup, and a heatwave). But there was still remarkable resilience in the face of rising energy and food costs. There was a 1.5% increase in professional, scientific, and technical activities output, some of which was attributed to AI-related spending. This was read as a positive potential lead indicator for future growth. The unemployment rate in the three months to August declined from 4.9% to 4.7%, vs expectations for a small rise to 5.0%. The single-month number was the lowest unemployment rate since the end of 2024, and youth unemployment (16–24-year-olds) fell to 15.6% from 16.4%, the lowest in nearly a year. Overall wage growth dipped from 3.9% to 3.7%, although the ex-bonus reading rose from 3.5% to 3.7%. Not enough there yet to spark fears of second-round inflation effects creeping into the labour market.

US. Core consumer prices rose by 0.3% in September, higher than the forecast, taking the annual rate up from 2.4% to

2.6%. The headline rate was 3.7%. While policymakers might be willing to look past the headline rate, in the hope that energy price inflation will be temporary, the rise in the core rate was a bit more concerning. Some of the increase is the result of rising prices for computers and smartphones because of the demand for components and raw materials for data centres. The upward pressure was also seen in the producer price indices, with core goods input prices rising at 5%, up from 4.7%. The initial reaction was to bring forward expectations for a Fed Funds rate increase, but that was pushed back again as investors' worries about AI-related capex growth resurfaced.

Europe. The October ZEW survey release of eurozone economic sentiment showed current conditions as stable but with expectations more pessimistic. Even so, it feels more like uncertainty than a collapse in confidence. Europe remains at the centre of concerns about higher energy prices and a short cold snap drove natural gas prices higher again. The benchmark price for a megawatt hour of gas energy now tops €90, up from below €30 before the Iran War. That's the highest price since late 2022, although still well short of the peak of €339 at the height of disruption following Russia's full-scale invasion of Ukraine. Within Europe, and despite political unrest, Germany seems to be

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recovering thanks a ramping up of government spending and transport on the Rhine improving as water levels rise again.

China. China Q3 GDP growth came in stronger than expected, at +4.5% y/y, in line with the government's 2026 target. September activity data also came in better. Industrial production (+5.5%) was supported by semiconductor output. Retail sales growth (+1.1%) strengthened, apart from a sharp drop in auto sales. Fixed asset investment (-7.2%) declined at the same pace as the prior month. Real estate remains weak, with investment contracting 20.6% y/y. Residential property sales were 13.7% lower than a year earlier.

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Greenbank
0117 930 3000
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