Need to Know

Analyst who predicted the 2008 crash warns of bubble brewing in U.S. household wealth

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By Barbara Kollmeyer

Critical information for the U.S. trading day

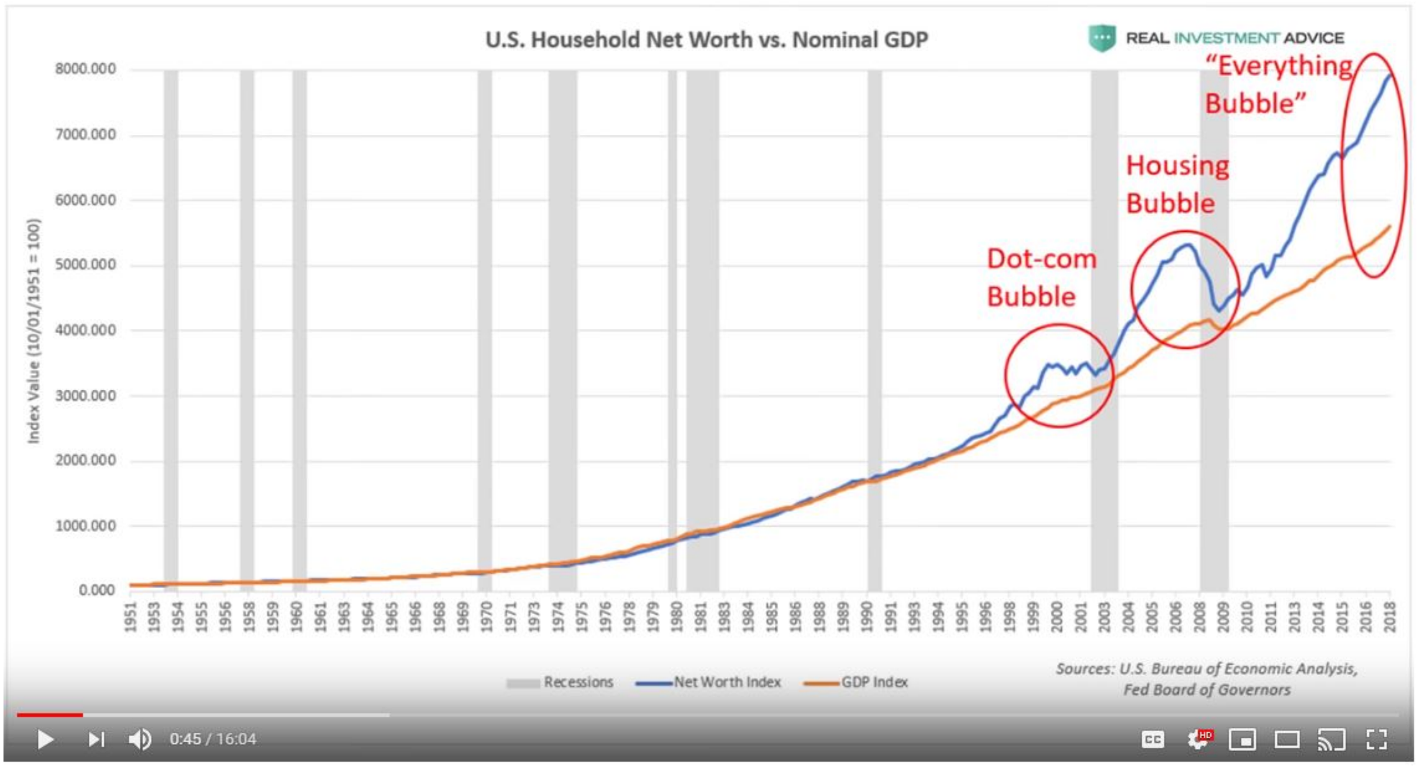
AFP/Getty Images

Much has been made about how much wealth is sloshing around in U.S. households and the significance of that fact.

Our call of the day, pulls no punches as it warns that all that oft-referenced increase in affluence, has been artificially inflated by the Fed, which is ultimately bad news for the economy and the stock market. Here's how Jesse Colombo, analyst at Clarity Financial, explains it:

“The U.S. household wealth boom since the Great Recession is a sham, a farce and a gigantic lie that is tricking everyone into believing that happy days are here again even though the engines that are driving it are bubbles that are going to burst and cause a crisis that will be even worse than the 2008 crash,” Colombo said in a video he posted via the Real Investment Advice blog.

There has been a fair bit of buzz on the topic since data this summer that showed household wealth topped $100 trillion for the first time in June. Colombo’s isn’t the only invective against bloated U.S. wealth and how it could go terribly wrong, but the commentary delivers, perhaps, the most potent argument to date, including charts, such as the following, that illustrates the degree to which wealth has been outpacing economic expansion:



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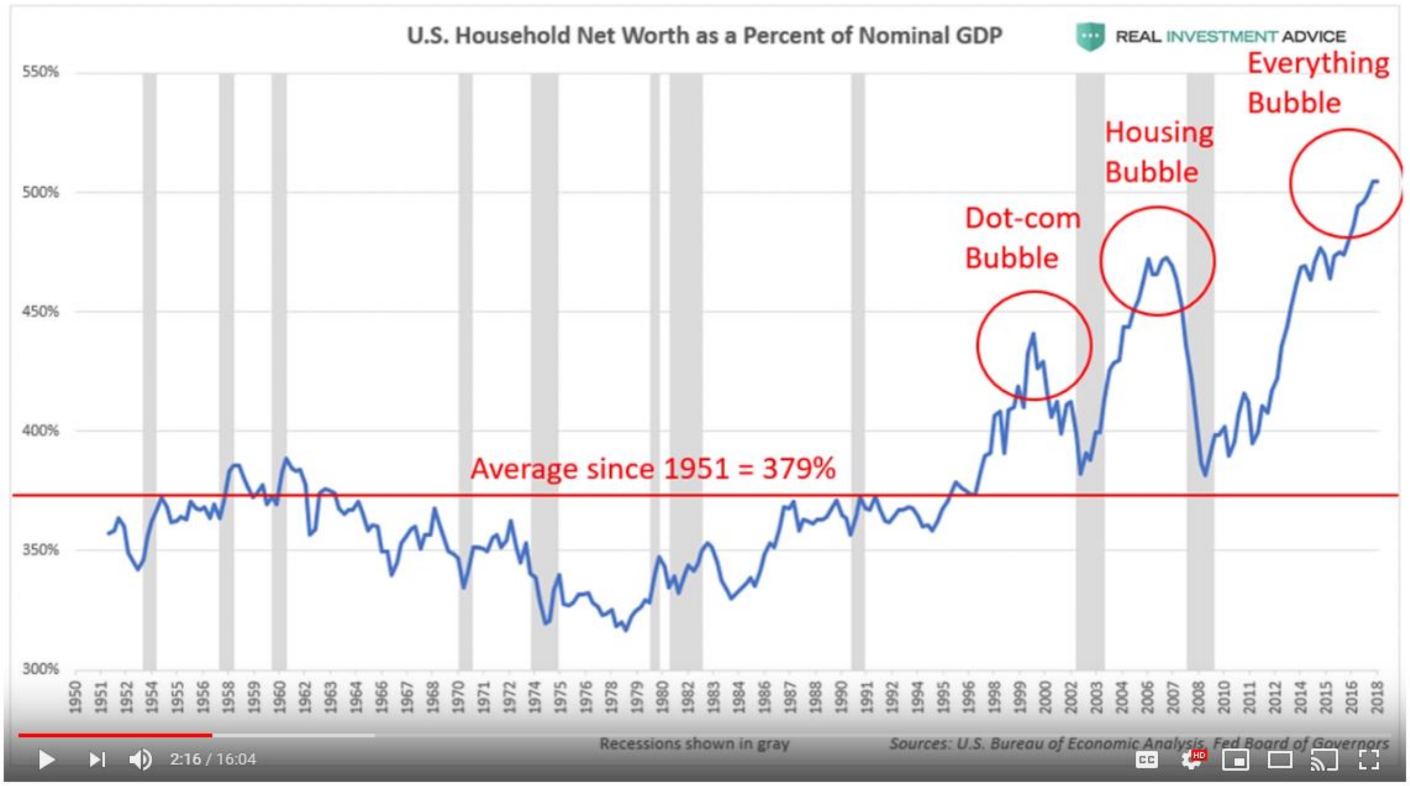
Wealth that gallops past economic growth is a “telltale sign that the boom is artificial and unsustainable, he said. The last two times the share of household-wealth growth exceeded gross domestic product, or GDP, was during the late 1990s dot-com bubble and the mid-2000 housing bubble, he notes. “Both of which ended in tears,” he said.

And that means the coming crash could be even more painful, warns Colombo.

Just below is another Colombo chart that shows how household wealth as a share of nominal GDP is running red-hot at 505%, vs 473% in the housing bubble peak and 429% in the dot-com bust. The current figure is totally out of whack, compared with the average of 379% that is sustained since 1951. All that means that a “violent reversion to the mean is inevitable,” he says.



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The primary driver of this bubble are common stocks, which have been on a yearslong march higher, and that includes those held by big mutual funds, he says. "Extremely-inflated" equities drive up that wealth, but such as in prior busts, they drag it right back down when a bear market, or decline of at least 20% from a recent market peak, takes hold.

Colombo believes equities are overvalued on several fronts such as a favorite indicator of Berkshire Hathaway's Warren Buffett—total value of stock market divided by GDP, which shows the market more overvalued than it was during the halcyon days of the dot.com era.

Housing prices are also way overinflated, and another contributor to that household wealth, a big chunk of middle class wealth, he says. Behind it all, is the Fed, which has sprinkled easy-money fairy dust all over the economy. And that central bank is going to bust the household wealth bubble right open, he warns, with rising interest rates and tightening monetary policy.

Just a scaremonger? Colombo, who blogs at The Bubble Bubble, is among a handful of market watchers credited with predicting the 2008 housing bubble and subsequent financial market collapse. By the way, he was still a college student; so, he offered up his prognostications via a website he built called "stock-market-crash.net."