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In 1999, just as today, when share prices fall, it isn't a delusion correcting. It's uncertainty resolving.

There's No Such Thing as a Stock-Market Bubble

By Jeff Yass

Every time the market falls, the pundits come out with the same diagnosis: It was a bubble, speculators lost their minds, and somebody should have stopped them. This time the pundits are early. They decided artificial intelligence is a bubble before anything had fallen. Really? Why would rational investors suddenly lose their minds?

Start with the word itself. What is a bubble? The bubble callers mean a price that hype has pushed above fundamental value. Notice what that assumes: that there is a true price, that the market has lost sight of it, and that when prices come down, reality is correcting a delusion.

This totally misunderstands prices under uncertainty and volatility. There is no true price to lose sight of. The value of a new technology is uncertain, and a price isn't a verdict on what it is worth. It is the market's best guess: every possible future weighted by its likelihood of payoff, made by millions of people with their own money on the line and more information than any pundit can hold. The market isn't "right." It's just a much better instrument for predicting value under uncertainty. When prices fall, that isn't a delusion correcting. It's uncertainty resolving.

Go back to 1999. An internet stock trades at $100 a share. If it turns out to be the next Amazon, it goes to $1,000. If it turns out to be the next Pets.com, it goes to zero. Say the market puts the chance of becoming Amazon at 15%. Do the arithmetic. Fifteen percent of $1,000 is $150, so at $100 the stock isn't expensive. Buying it is a sensible bet.

Now it turns out to be Pets.com, and the stock goes to zero. Was it a bubble? No. The buyers were betting on a 15% shot, and the 85% came in. The best guess of the stock's value was $150, and the most likely outcome was zero. Both were true at once, but most pundits can hold only one of those ideas in their heads. And 15% isn't rare. A random day is a Tuesday about 14% of the time, and nobody is shocked when it's Tuesday.

Even the winners looked like bubbles at the time. Amazon fell more than 90% from its 1999 peak. If you judged it by the crash, you'd have called it a bubble too. Yet investors who held the whole sector long enough came out ahead, because a few spectacular winners paid for all the Pets.coms.

That's how the entire stock market works. Hendrik Bessembinder of Arizona State University studied every U.S. stock since 1926. Surprisingly, most of them returned less than Treasury bills over their lifetimes, and about 4% of companies produced all the market's net gains. Most bets lose, and a few huge successes pay for everything. If every losing bet counts as a bubble, then the market has always been one.

Losing a bet doesn't make it irrational. When the Knicks were down 29 points against the Spurs in Game 4, the betting markets gave them about a 3% chance. They came back and won. Anyone who said the bookies were wrong was wrong about the bookies: A 3% chance comes in 3% of the time. But that doesn't make the bookies right, either. The most you can say is that the sportsbook was smarter than any one bettor. Once you know the ending, it's hard to remember that you didn't.

Artificial intelligence is where the internet was in 1999. Nobody knows how big it will be, which firms will win, or whether the winners will end up 100 times bigger or 10,000 times. That uncertainty makes prices swing harder in both directions, and a small chance of an enormous payoff is worth a lot today, so prices across the whole field look too high to anyone who isn't thinking in probabilities.

Prices will probably come down, as the uncertainty resolves and winners and losers shake out. What the bubble callers can't tell you is when, how high prices get first, or how far they fall. When the fall comes, it won't prove anyone was irrational. It won't

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even mean the prices were too high. It will mean the uncertainty resolved, and the small chance of an even bigger payoff that was holding prices up didn't come in.

Hype is real, and it moves prices. But the speculators buying and selling AI stocks know that and factor it in with their own money at risk. The idea that hype is something a talking head understands and the market overlooked is absurd. It's in the price.

The market says this out loud. Options are insurance policies on stocks, and their price tells you how big a swing the market expects. When options on AI stocks are expensive, the market is announcing that a crash is possible. If a crash comes, you can't say "I told you so." The market told you first, in public, on an exchange.

Do you know anyone with a good record of predicting bubbles? Neither do I. Calling a bubble is a free option. If the market craters, you're famous. If it doesn't, you go into never-mind mode and call the next one. If the bubble callers know the true price and the market doesn't, let's see the track record.

The bubble story survives because it flatters people who can't beat the market. But being rational isn't about being right, and being irrational isn't about being wrong. Rational is being smart and humble about uncertainty. Irrational is being dumb and arrogant about it. It is arrogant to believe you know more than the market, and you'd be a fool to listen to a pundit who says he does.

So here's a rule. If you think AI is a bubble, buy puts. The most you can lose is the premium, and if you're right, you'll get rich and have earned it. If you won't buy them, then when the market falls, don't call anyone irrational. The market called it first.

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