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**Why It's So Hard to Spot A Stock-Market Bubble**

THE INTELLIGENT INVESTOR |

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A sudden surge in share prices makes us all think we know what's coming next

If the stock market's a bubble, that's dangerous. If you're positive it is—or isn't—a bubble, that could be even more dangerous. In April, semiconductor stocks rose more than 38%, their highest monthly return since February 2000. Google's parent, Alphabet, gained 10% on April 30, adding more than \$421 billion in market value in a single day—the second-largest one-day gain for a stock in history, according to Dow Jones Market Data.

In a recent issue of my newsletter, I asked: Are we in a bubble? Readers from across the U.S. and around the world weighed in.

"In short, YES," emailed Peter Hansen, a reader in Paraguay. "We are definitely in a bubble," said Tom Hagedorn, who lives in Ohio. "No, it's not a classic bubble," said Christoph Stahl, a reader in Munich. Kathryn Ashby from Florida echoed Stahl's sentiments. "While the increase in prices is extraordinary, prices continue to rise because earnings continue to rise," she wrote. "Earnings are the mother's milk of the market." *Note*

Sorry, folks. As I've warned before, bubblespotting is a lot harder than it seems. If identifying a bubble were easy, then we all could do it. And, if we all could do it, then a bubble wouldn't form in the first place. *Note*

Investors would see it starting to swell. Then they would promptly sidestep or bet against it, deflating the bubble before it could expand anywhere near the bursting point.

What's more, it's easy to misinterpret overpricing for part of the market as an indication that everything is a bubble. Much of the time, at least some firms or industries will be going up fast enough and high enough to seem like a bubble.

Even when stocks look expensive, as they already did several years ago, it's hard to be certain they're doomed to collapse. After all, few people back then correctly anticipated how giddy investors would later get over artificial intelligence. And after AI, some other transformative technology could emerge—just as AI has supplanted the enthusiasm over cloud computing, fracking, the internet and earlier breakthroughs that lifted the market.

A few variables can take some of the guesswork out of trying to identify a bubble. Owen Lamont, a portfolio manager at Acadian Asset Management in Boston, has written extensively about market extremes.

One definition of a bubble, he jokes, is “when I think the stock market is overpriced and then it doubles,” as in 1999. (That year, the Nasdaq 100 index gained 102%, after returning 85% in 1998.)

More seriously, Lamont looks back and identifies several indispensable ingredients for a bubble: not just high stock prices, but also high volatility and trading volume, as well as the spread of what he calls “bubble beliefs.”

“If you're at the gym or getting a haircut and everyone is talking about ‘Are we in a bubble,’ ” says Lamont, “that's a pretty good clue that we might be in a bubble.”

I would note another necessary ingredient: defensiveness.

When fans of an overpriced asset go from touting its benefits to attacking its critics, you can be fairly sure it's becoming a bubble. That's what happened in late 1999 and early 2000 with internet stocks and in 2021 with bitcoin, when proponents lashed out at skeptics—right before prices collapsed. That tone isn't dominant today, suggesting to me that we're still not in the red zone.

The last of what Lamont calls “the four horsemen” of a bubble is a tidal wave of stock issuance.

Think of 2020-2021 when hundreds of special-purpose acquisition companies, the black boxes called SPACs, issued new stock. When that bubble burst, outside investors lost at least \$100 billion.

Or consider the dot-com mania of the late 1990s, when eToys, Pets.com and hordes of other flashin- the-pan internet companies drenched the market with initial public offerings of stock.

So far at least, new stock offer-ings haven't been flooding the market. That looks likely to change, though, if SpaceX, Anthropic, OpenAI and other giants go public later this year, as widely expected. “Issuance is the thing I'm keeping my eye on,” says Lamont.

The ultimate sign of a bubble is performance-chasing behavior. An asset goes up in price because people are buying it, so more people buy more of it, making the price go up even more.

In recent months, though, what we've seen is the opposite: Individual investors have been buying stocks on bad news about tariffs or war or inflation. This is contrarian, not performance-chasing behavior.

“A bubble is buy the rip, not buy the dip,” says Lamont.

That isn't the only hazard. You can also try to be too clever by half. After all, if you're positive you can identify a bubble, why wouldn't you believe you can predict when it will burst? In that case, why not buy the riskiest stocks that will boom the most?

The real danger of bubblespotting is believing you can do it. Several readers told me they've amped up their exposure until they're all in, while others said they've bailed on stocks in response to the market's rise.

But stocks aren't a toggle switch that you flip on or off. Few investors should have either all or none of their money in stocks. The future is rarely certain enough for that.

Now is a good time to make sure you're diversified, holding not just the S&P 500 but smaller stocks and international stocks as well. You should also check whether you can rebalance—trimming some winning assets, such as large U.S. stocks, to add some recent laggards like bonds.

Also be on the alert for any signs your financial adviser is sure we're in—or not in—a bubble. They don't know any better than you do.

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