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PHILEQUITY CORNER

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Irrational exuberance

Last week, Alan Greenspan died at the age of 100. He served as the Fed chair from 1987 to 2006. He steered the Fed through major economic events such as the stock market crash in 1987, the technology boom in the 1990s and the bursting of the dotcom bubble in the early 2000s. Greenspan was famously known for coining the phrase “irrational exuberance” which served as an early foreshadowing of the dotcom bubble.

Fedspeak

As a longtime Fed chief, Greenspan became one of the most influential central bankers in history. The term “Fedspeak” was coined during his term. This describes his cautious, ambiguous, cryptic and technical style of communicating. Greenspan realized that investors and economists are sensitive to his views, and he structured his messaging to avoid stoking unnecessary market volatility. He believed that providing too much clarity would reduce the Fed’s flexibility. After his term, Fedspeak evolved as the subsequent Fed chairs shifted toward a clearer communication style by giving forward guidance.

Importance of the Fed

The Fed’s policy moves and statements have significant implications on the economy and drive the movements of various asset classes such as stocks, bonds, currencies and commodities. We wrote several articles in this column to explain the importance of understanding the policies and pronouncements of the Fed and other central banks. We also dedicated a chapter in our book “Opportunity of a Lifetime” to discuss this. The power of the Fed could be seen in Greenspan’s immense influence during his term and his foreboding speech on irrational exuberance. The importance of the Fed was also evident during Ben Bernanke’s decisive rescue, unprecedented policy easing and reassuring forward guidance following the Global Financial Crisis in 2008.

A new Fed era under Warsh

Last month, Kevin Warsh started his term as the new Fed chair. On June 16-17, he presided the first policy meeting under his leadership. By parsing through his statements, we can deduce that Warsh will be quite different from his recent predecessors. He deliberately abstained from giving a dot plot projection. Like Greenspan, Warsh believes that providing explicit forward guidance could hamper future policy. His pronouncements carried a hawkish tilt as he signaled the Fed’s renewed focus on price stability. Moving forward, it would be crucial for investors to understand how the Fed will evolve during the term of Warsh.

Ominous warning

In a speech in 1996, Greenspan asked, “How do we know when irrational exuberance has unduly escalated asset values?” He openly pondered whether stock prices became disconnected from underlying fundamentals. In the mid-to-late 1990s, share prices of internet and technology companies surged on the expectation that the internet revolution would usher explosive earnings growth. However, the run-up was driven by speculative frenzy as many of these companies had little to no profit. The stock market continued to rise for three years after Greenspan’s warning, but it eventually crashed in 2000-2002 after the dotcom bubble ended.

AI boom

In the last few years, the share prices of companies in the AI value chain experienced a spectacular run-up. Since the start of 2023, Nasdaq has more than doubled while Nvidia has gone up by 1,200 percent. This year, the surge in the stock prices of certain companies is even more staggering. For example, Sandisk is up 782 percent year-to-date and 32 percent in the past month, while Micron has gained 297 percent this year and 26 percent in one month. The magnitude of the jump in AI and tech stocks is indeed comparable to the steep ascent of internet stocks during the dotcom era.

Another period of irrational exuberance?

Greenspan's death and the swiftness of the AI run-up have left investors wondering if we are witnessing another period of irrational exuberance. Some are worried that this is the bursting of the tech bubble (see *Has the tech bubble burst?*, June 8, 2026). Many tech companies have fallen sharply in the last few weeks. The biggest US tech stocks - The Magnificent Seven - are down 10 to 20 percent from recent peaks due to concerns regarding their substantial tech investments. This also coincides with thinning market liquidity due to fundraising activities such as the biggest IPO ever and huge secondary placements.

Earnings-driven

Amid growing investor concerns, it is crucial to differentiate the dotcom bubble from the current AI boom. The share prices of dotcom internet stocks skyrocketed even though most of them did not make money. In contrast, the generational ascent of AI stocks is driven by exceptional earnings growth. As a result, price-to-earnings ratios are still within reasonable levels despite the jump in share prices. There is a massive AI infrastructure buildout in light of the growing demand for AI. Recently, the key beneficiaries of the AI trade have been companies who make semiconductors, memory chips and AI hardware.

The latest correction in the tech sector may be signaling that the market has topped. On the other hand, this pullback may be considered justified as it takes the froth out of a stretched stock market. Moreover, some level of volatility may be expected in light of the epic rise of tech stocks. We are also seeing profit-taking, rotation and broadening which is actually healthy for the overall market.