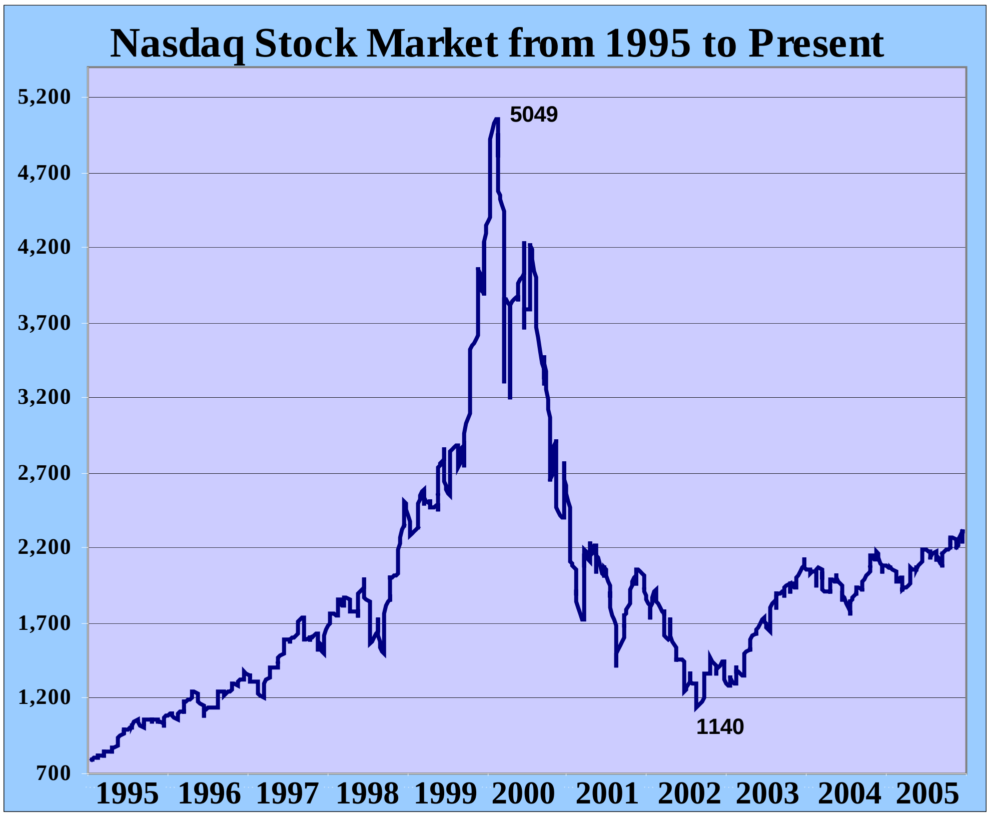
11: The Dot-Com Bubble Of The 1990s and Its Lessons For the Current Real Estate Market

Most of us remember the Dot-Com bubble, the most recent and therefore for many of us most concrete example of a bubble bursting. We heard of dot-com millionaires, Silicon Valley became synonymous with Super Bowl commercials, and new dot-com companies popped up every day. At a certain point though, enough people realized that these dot-com companies were not earning profits and that they never would, and that change in mentality meant that the dot-com boom was over. Below is a graph showing the meteoric rise of the NASDAQ to 5,049, and subsequent plunge to 1,139.



One of the reasons for the NASDAQ's rise is that in the late 1990s the Federal Reserve under Alan Greenspan lowered interest rates, which encouraged venture capitalists to invest their capital in Internet startups. The problem was that with all of the capital flowing into this sector spent on advertising the capital did not translate into consumer spending which ultimately was the downfall of many companies.

One of the lessons learned in the dot-com bust is the greater fool theory. As long as a greater fool came along and bought your stock for a higher price, you were okay. Rather than the smart money that gets out before the top, the term dumb money cropped up to represent the unknowing investor who blindly bought following the crowd, 'the greater fool'. Real estate investing presents an even larger threat for the 'greater fool theory' as people feel more secure investing in real estate and taking on large mortgages to pay for it. The 'greater fool theory' is like the classic