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AHEAD OF THE TAPE

By JUSTIN LAHART

Cheap Money Doesn't Explain Market Puzzles

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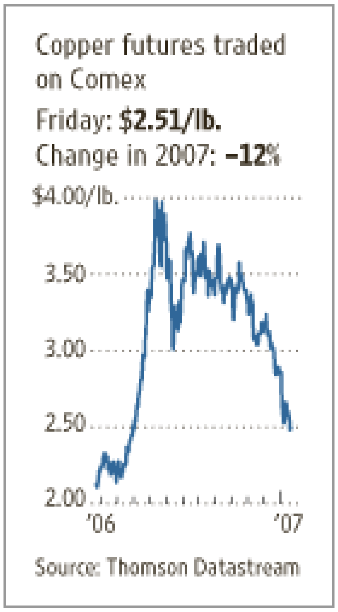
If the world is awash in cash, why isn't the cash washing up everywhere?

A surfeit of cheap money has become the default explanation for the market's many conundrums these days. Consider the following. Long-term Treasury yields are lower than short-term Treasury rates -- a recessionary signal -- at the same time that low yields on corporate and emerging-market debt signal a strong economy. Market watchers have hit on the idea that the markets are so soaked in free-flowing cash that investors will throw it at just about any asset. They'll gobble up Treasury bonds and corporates at the same time, driving yields of both down, even if that sends contradictory signals about how they view the world.



It isn't just traditional investments whose prices are getting driven higher, but nontraditional ones, such as classic cars, first-growth Bordeaux and pop art.

Yet at a time when paintings of soup cans attract ever-higher bids, the price of an actual can of soup, along with myriad other humdrum items, has hardly risen. Soup prices, in fact, were flat last year, according to the Bureau of Labor Statistics. If the world is so awash in cash, prices for everyday stuff probably ought to be heading higher, too.

ITG economist Robert Barbera says the workings of the global economy are one explanation. More is produced cheaply in low-cost countries like China. That keeps the prices of everyday items low. At the same time, globalization has helped some people amass vast amounts of wealth, putting more money in the hands of investors and high-end spenders.

"There are billionaires in China, there are billionaires in India, there are billionaires everywhere, and they all want to drink Haut-Brion, which means I can't!" Mr. Barbera says.

WALL STREET JOURNAL VIDEO

[1]
WSJ's Jon Hilsenrath discusses[2] the strong liquidity in the market and how it's affecting bond yields and creating bidding wars in the buyout market.

Money, too, is flowing more freely globally. Low interest rates in countries like Japan are helping to finance investments around the world. Meanwhile, a host of derivative instruments lets investors spread cash across different asset classes and countries like never before.

Dresdner Kleinwort strategist Albert Edwards says awash-in-cash theories might be getting it all backward. Investors might not be pushing up prices for assets like art or high-yield bonds because they have so much cash. They might be seeking out more and more cash so they can push up prices while the going is good. Once they lose faith in an asset class, in other words, they'll turn tail and all of that so-called liquidity will turn with them.

That's what happened in the copper market. Copper prices surged early last year, partly on the idea that emerging markets were soaking up supplies, and partly on the idea that it was a hot destination for the excess cash sloshing around the world. But with copper stockpiles growing, the fundamentals got in the way. The price of copper has fallen 39% since May.

By the same token, all that cash doesn't seem to be pushing up prices for Florida condos or, for that matter, oil anymore.

"Liquidity is an ex-post justification for why markets are going up," Mr. Edwards says. "There's lots of liquidity around -- well, there always is until there isn't, and then it just disappears."

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