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BLOOM & BUST

HARNESSING ECONOMIC CYCLICALITY FOR ENDURING GROWTH, WHILE DODGING MARKET MANIAS

Photo Credit: wili_hybrid

Value and Valuation

What defines the price we pay for something, and who decides its worth?

The word “value” originates from the Old French word “valoir,” which originally connoted “to be strong.” In its original sense, “value” referred to the usefulness or significance of something. It encompassed both tangible and intangible qualities that determined the importance or desirability of an object, idea, or action. Over time, the concept of value became closely associated with economic principles, particularly in terms of the exchange or trade of goods and services. However, it does not seem a leap to assume many would agree that ‘significance’ and ‘usefulness’ are moving targets, applicable in shifting degrees depending on context and to whom you’re talking.

People ultimately define these concepts based on need, want, and perceived desirability, according to various overt and occult historical, cultural, and seemingly arbitrary factors. In the 17th century, the Dutch pushed the physics of value to a logical extreme with their desire for a product that, while beautiful, had no intrinsic use case—something that, while not proverbially grown on trees exactly, can sprout quite easily from the ground through poor, sandy soil—Tulipa gesneriana.

The tulip.

The Seeds

Despite its modern association with the Netherlands, the flower is not native to the region. It did not in fact reach the Dutch until at least the late 16th century.

Originating in the mountainous regions of Central Asia (where the Tien Shan and Pamir ranges meet), early wild tulips moved westward with the Turkic tribes of this otherwise unforgiving, desolate region, their bright colors revered by these pre-literate[1] societies, in some cases reminiscent of the lifegiving vibrancy of blood. By the mid-11th century AD, they were being cultivated by various Near Eastern civilizations, including the Persians and later the Ottomans, who admired their beauty and elegance—tulips frequently appeared in gardens and verse, symbolic of perfection, eternity, wealth, and paradise on earth.

(However, it is important to note these tulips were not of the final type that precipitated the Dutch bubble; those were eventually bred from these more squat, uniformly colored, and hardier varieties, favoring longer, more delicate petals and wild color schemas.)

The tulip was likely introduced to Europe by various Western travelers around 1550. However, one man did more than most to introduce this flower to the nation that would later make them (in)famous, a man whose motives could only be described as pure, for the love of botany and beauty.

Carolus Clusius was deeply passionate about botany and devoted his life to the study and cultivation of plants. His meticulous observations and writings on tulips helped expand the scientific understanding of these flowers and their cultivation techniques. Originally born in the French city of Arras as Charles de l'Écluse to a marginally noble house, his lordship was so poor that he was forced to gain an education and work for his living, to which his mind was suited. An able student, he latinized his name to Carolus Clusious early in his studies, aligning himself with the burgeoning humanist movement that greatly valued the texts and writers of the Classical age. At a time when botany was not a district field, firmly subsumed by medicine and pharmacology, he helped to elevate its standing for its own sake and acquired a name as the go-to person for your plants—useful in many cases for the token gratuity provided, as he was relatively poor for most of his life and never made a fortune from horticulture (dying before the tulip craze really took off).

Through his connections, he maintained extensive networks of contacts within the scientific community and among affluent patrons, distributing tulip bulbs to fellow botanists, scholars, and collectors across the Netherlands, as well as other parts of Europe. This facilitated the spread of tulips and contributed to their growing popularity as ornamental plants among the well to do. Of course, as fashion breeds fashions, this popularity quickly spread to the more aspirational among the lower, middle, and burgeoning upper-middle classes.

Of course, as this interest grew and spread, it offered opportunities for enterprising, and sometimes unscrupulous actors in pursuit of a quick guilder or two (thousand).

Florists, Apothecaries, and Rhizotomi

While Clusius's involvement with tulips stemmed from a genuine passion for botany and scientific inquiry, the tulip trade also attracted a different kind of participant—to start, florists, apothecaries, and rhizotomi (Greek for "root cutter"). The rhizotomi were iterant individuals who travelled the European countryside procuring or spiriting away less common bulbs and specimens to sell to interested collectors and botanists. While some of these rhizotomi had a sense of honor and responsibility, ensuring that their products were what they claimed (to the best of their ability), on the whole they were considered a bit unscrupulous. It was difficult for even experienced professionals to tell the flower type that would sprout from a plain brown bulb, so many rhizotomi would pass off inferior or common varieties as sought-after rarities, disappearing across borders in the general anonymity of the times with their ill-gotten gains months before their graft was discovered.

Florists and apothecaries, being relatively stationary, generally had to be a bit more trustworthy, but on the whole were less interested in the product and more interested in the prices someone was willing to pay for it. Many hired vagabonds and bandits to raid well-known tulip gardens for specimens (although many respectable collectors and academics were not above this practice), sometimes selling them back unbeknownst to the robbed party at inflated prices. The more dishonest of the bunch would also hawk their wares with dubious, untested claims, such as grinding up and selling defective or damaged tulip bulbs as aphrodisiacs.

"THE REALIZATION THAT TULIP BULBS DID NOT JUSTIFY THEIR ASTRONOMICAL PRICES LED TO A COLLECTIVE REASSESSMENT OF THEIR VALUE, CONTRIBUTING TO THE COLLAPSE OF THE SPECULATIVE BUBBLE. AS PRICES STARTED TO DECLINE FROM VARIOUS DIRECTIONS, PANIC SPREAD AMONG INVESTORS, LEADING TO THE FRENZIED SELL-OFF OF BULBS."

The Bubble

All of this peaked in the winter of 1636-1637, when the frenzy became a mania, characterized by extreme speculation, frantic trading, and unsustainable price escalation.

Because of their initially high prices and scarcity, the demand for tulips had expanded from niche collectors to the more general population, particularly the better off (although some modern scholarship suggests the scope was more limited than historically supposed[2]); rare tulip bulbs had become a status symbol, leading to feverous competition among the elite to acquire the most prized varieties. The allure of social prestige, a burgeoning interest in the natural world in the aftermath of the religious wars of the previous century, and the desire to participate in a fashionable trend drove many individuals to invest heavily in tulips, further inflating prices. Rare and prized varieties commanded exorbitant sums, with prices rising daily. Some bulbs were reportedly traded for the equivalent of a luxurious house or even several years' income of a skilled craftsman.

The Semper Augustus was one of the most coveted and sought-after varieties of tulips during the height of the mania. It was distinguished by its striking red and white petals, which were intricately streaked and feathered, making it exceptionally rare and beautiful.

In February 1637, at the height of the "tulipomania," a single bulb of the Semper Augustus variety reportedly sold for the equivalent of 6,000 guilders. To put this into perspective, this sum exceeded the annual income of a skilled craftsman not by degrees, but by orders of magnitude. 6,000 guilders in the 17th century would be equivalent to hundreds of thousands, if not millions, of dollars today (although direct comparisons are impossible).

The Viceroy tulip was another highly sought-after variety; a single bulb was reportedly exchanged for a staggering sum in the form of goods, including the following items:

- Two lasts[3] of wheat and four lasts of rye
- Four fat oxen, eight fat swine, and twelve fat sheep
- Two hogsheads[4] of wine and four tuns[5] of beer
- Two tuns of butter
- One thousand lbs. of cheese
- A complete bed
- A suit of clothes
- A silver drinking-cup

However, everyone from merchants to artisans to farmers became involved in trading tulip bulbs, as some of the less refined varieties were, as stated, aspirationally in reach for those willing to stretch their savings. This widespread participation contributed to the rapid escalation of prices as demand soared.

One of the key mechanisms driving the mania was the trading of tulip futures contracts, a relatively new innovation developed in its modern form during this period. These contracts allowed investors to speculate on the future price of tulip bulbs without actually owning them. Traders would enter into agreements to buy or sell bulbs at a predetermined price on a future date. In addition, margin trading, where investors borrowed money to finance their tulip bulb purchases, was prevalent during this period. This practice amplified both gains and losses, as investors could leverage their investments to control larger positions in the market. However, it also increased the risk of financial ruin for those who borrowed heavily and were unable to repay their debts when prices collapsed, while contemporary scientific limitations and the glut of unscrupulous actors did not allow one to know with absolute certainty what would sprout from the ground from any given bulb after any given exchange.

None of this would have been possible if many investors weren't caught up in the belief that tulip bulb prices would continue to rise indefinitely. This collective optimism fueled a self-reinforcing cycle of buying and price escalation, with few investors willing to sell their bulbs for fear of missing out on further gains. Importantly, this market operated with little to no regulation during this period, allowing speculation to run rampant unchecked. Without oversight or safeguards in place, the market became susceptible to manipulation and fraud, exacerbating the volatility and instability of prices.

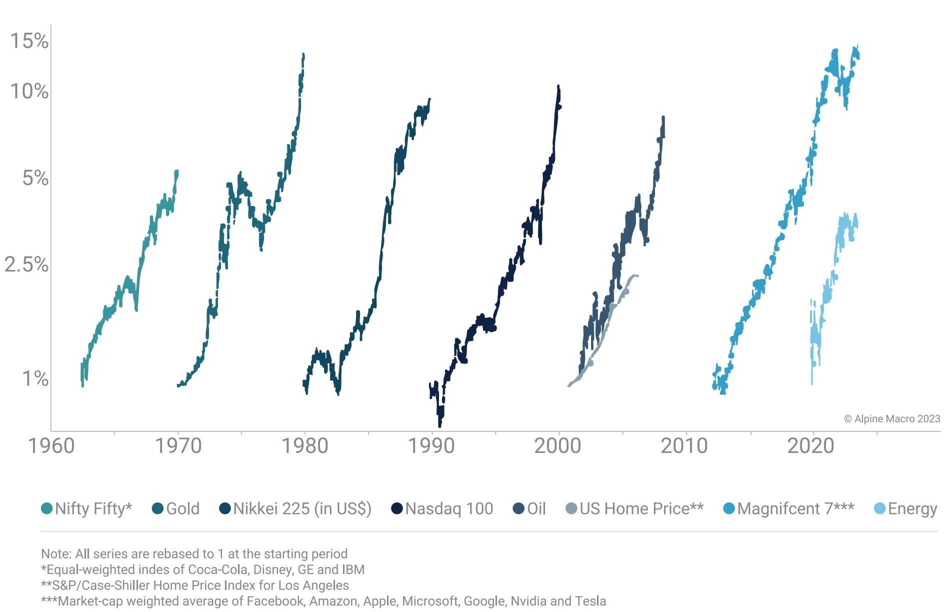
As the speculative frenzy reached its peak, the tulip market became oversaturated. Supply began to outstrip demand as more people sought to cash in on the soaring prices by selling their bulbs. Eventually, as prices continued to rise, some investors began to grow increasingly wary of a market collapse. The fear of missing out (FOMO) turned into fear of losing everything, leading some to start selling their tulip bulbs to secure profits before prices plummeted. And as the number of sellers increased and confidence in the market waned, the market experienced a sudden shortage of buyers willing to purchase tulip bulbs at inflated costs, intensifying the downward pressure on prices.

Perhaps most importantly, investors eventually began to realize that tulips, while beautiful and uncommon, were ultimately just flowers with limited practical utility. The realization that tulip bulbs did not justify their astronomical prices led to a collective reassessment of their value, contributing to the collapse of the speculative bubble. As prices started to decline from various directions, panic spread among investors, leading to the aforementioned frenzied sell-off of bulbs. This rapid and widespread liquidation of assets further accelerated the decline in prices, creating a self-reinforcing cycle of panic and selling.

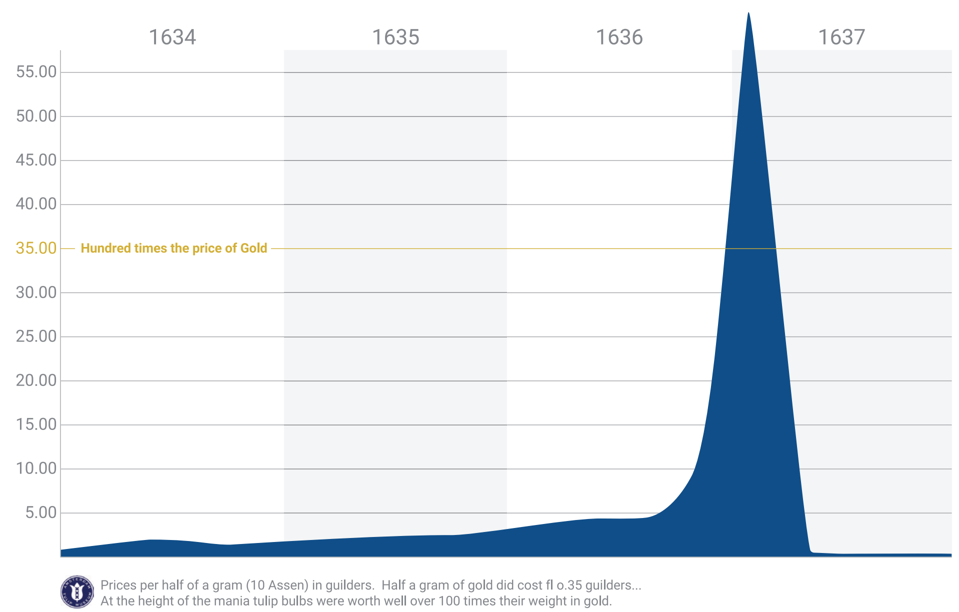
In an attempt to stabilize the market and prevent further economic turmoil, the Dutch government stepped in to regulate the tulip trade. In February 1637, the government issued a decree allowing traders to void their contracts by paying a small penalty, effectively halting the escalation of prices. By the spring of 1637, the tulip bulb market had collapsed completely, with prices plummeting to a fraction of their former value. Some speculators who had borrowed heavily to finance their tulip bulb purchases were left bankrupt, while others suffered significant financial losses. While the tulip bulb trade never fully disappeared, the speculative excesses of tulipomania have gone on to serve as a cautionary, seemingly almost apocryphal story about the dangers of irrational exuberance and speculation in financial markets more broadly.

Flower Power

Generations later, it was learned that the tulips most prized for their beauty, delicacy, and fine striations of color were actually affected with a virus[6] transmitted by aphid bugs that weakened and elongated their petals while disrupting their natural expression of more uniform coloration. The more exquisite the flower, the more fragile and diseased.



Source: Amsterdam Tulip Museum



Source: Alpine Macro

Solution Looking For a Problem

Tulipomania didn't arise from nowhere. It came at a time of flux and arguably unprecedented change for the Dutch, with Europe reeling from many of the birthing pangs of shifting identifies and political (r)evolution that would eventually lead to the modern Western world.

Immediately prior to the height of tulipomania, the Dutch Republic had experienced a period of economic downturn in the 1620s. This recession led to financial hardship for many individuals and exacerbated social tensions within Dutch society. And while the Dutch Republic itself was not directly involved in the conflict, the ongoing Thirty Years' War[7] was deeply intertwined with the economies of major European nations, disrupting major trade routes throughout Europe, including those vital to the Dutch Republic's economy. As a major trading hub, the Dutch Republic relied heavily on international commerce for its prosperity. The disruption of trade routes had ripple effects on Dutch merchants, who faced challenges in transporting goods and conducting business with trading partners in war-torn regions.

All of these things created an environment that was ripe for echo-chamber opportunism and speculation untethered to reality.

Tulipomania exemplifies how people can get caught up in a financial craze even when something doesn't have real value (defined as something that is inherently useful). A collective illusion—reality, like worth, is in large part based on consensus. However, the bursting bubble had a real impact on real people, putting actual livelihoods at stake in some cases, even though we are talking about a flower, not real estate or housing. Even that which is in itself without worth can find a profitable enough niche if enough people believe it to be worth their time.

During the late 1990s, the rapid rise of internet technology sparked a speculative frenzy leading to the infamous dot-com bubble. Investors poured billions of dollars into internet-related companies, often without

IS CRYPTO A TULIP DISGUISED BY DIGITAL PETALS?

"While it is true that there are few "real life" applications for cryptocurrency, it is far too early to say for certain if Bitcoin or other digital currencies are practically useless...Matt Hougan, writing for Forbes, compares Bitcoin with oil in the 1850s. Back then, oil was used only for lamps and machine lubrication...with combustion engines and technological advancements, oil became one of the most valuable commodities in the world. Perhaps something similar will happen with crypto."

https://bigthink.com/the-present/greater-fool-theory-cryptocurrency/

regard for their profitability or the sustainability of their business models. Much like tulipomania, the dot-com bubble was characterized by sky-high valuations based more on hype and potential future earnings than on tangible assets or earnings. When the bubble inevitably burst in the early 2000s, countless internet startups went bankrupt, wiping out billions of dollars in investor wealth.

More recently, the meteoric rise of cryptocurrencies has drawn parallels to historical speculative bubbles. While proponents tout these as revolutionary digital assets with the potential to reshape the financial landscape, skeptics warn of a speculative bent reminiscent of past manias, with both the extreme volatility and inherent lack of intrinsic value in many cryptocurrencies echoing the speculative excesses of tulipomania, raising concerns about the sustainability of their valuations. Bitcoin and Ethereum are increasingly establishing themselves as digital staples with real-world applications, but the proliferation of newer coins and “memecoins” continues to fuel doubts about their legitimacy and long-term viability.

Similarly, concerns are growing over the concentration of market value among the so-called “Mag 7” of the S&P 500—tech giants whose dominance now represents an outsized share of the index’s performance. While these companies are undeniably profitable, their market concentration raises core systemic risks, echoing the speculative fervor seen in past bubbles. A sharp correction in just one or two of these giants could ripple through broader markets, highlighting the vulnerability of portfolios overly reliant on a narrow set of winners. For long-term investors, this underscores the importance of diversification and the potential perils of chasing momentum in an increasingly concentrated market.

However, on the other hand, take the rising tide of virtual reality (VR), still in its infancy and not much more than an interesting diversion at the moment. While VR’s offering of a “collective illusion” refers to a different version of the concept entirely, should enough people decide that the ease and comfort of a virtual experience trumps the labor- and time-intensive demands, not to mention imaginative limitations, of physical interactions, such an experience may find traction akin to that of the ubiquitous iPhone. Who among those old enough to remember growing up in the 70s, 80s, or even 90s could seriously say that they imagined their lives would be spent in large part glued to a palm-sized screen through which the majority of their daily interactions and life would unfold? In many ways, in this case, the behavioral groundwork has arguably already been in large part laid.

But such things as the rise of cryptocurrency and the speculative nature of emerging technologies like VR serve as reminders that no one really knows what the “next big thing” will be. While these trends may signal significant shifts, without sufficient scrutiny and grounded perspective, investors risk being swept up in momentum rather than aligning with sustainable, disciplined practices informed by the fundamental laws of finance and history.

These innovations do not necessarily offer a better way of being or doing, but rather a novel one—solutions searching for a problem. The success of such trends hinges on whether enough people decide the perceived problem is real enough to justify the change. If a critical mass begins to value the virtual over the physical, the speculative foundation for another “tulip mania” could be laid. That said, this does not mean cynicism should dictate our outlook; niche applications for crypto and VR already demonstrate meaningful use cases, solving specific pain points and offering alternatives to traditional modes of interaction. Much like Dutch merchants who chose to prize the unique aesthetics of virus-riddled tulips over their wild-growing, healthier counterparts, people may come to prefer the unfamiliar for its novelty and appeal, regardless of its intrinsic value. The new is not inherently wrong, but for it to thrive, it requires a dedicated following that sustains its momentum, even if its practical worth remains uncertain.

Valuing Value

Central to this concept of recognizing true valuation is the distinction between intrinsic value and market price. Intrinsic value represents the underlying worth of an asset based on its fundamental characteristics, such as cash flows, earnings potential, or, perhaps most importantly for our discussion, utility. Market price, on the other hand, is the price at which an asset trades in the market, influenced by factors like supply and demand, investor sentiment, and speculative fervor. Investors who focus solely on market price without considering intrinsic value are susceptible to the pitfalls of speculative excess and irrational exuberance.

The idea that "the price you pay for something matters" is a cornerstone of rational pricing. According to this theory, asset prices in efficient markets reflect all available information and are therefore rational and fair. However, as seen, the reality is often far messier. The excesses of tulipomania, the dot.com bubble, etc., serve as a stark reminder that markets are not always efficient and that prices can become detached from underlying fundamentals, leading to misallocations of capital and systemic risks.

Of course, human psychology plays a crucial role in driving these prices and fueling speculative bubbles. Behavioral biases such as greed, FOMO, and herd mentality can cause investors to irrationally chase trends and disregard fundamental valuation principles. During the tulipomania, the fear of missing out on lucrative profits drove many investors to participate in the frenzy, while in modern markets, the rise of social media and online forums can amplify herd behavior and exacerbate speculative excesses, making it vital for investors to remain vigilant and disciplined in their decision-making.

Ultimately, the price you pay for an asset significantly impacts your long-term return potential and risk exposure. Quite simply, buying an overvalued asset at inflated prices increases the risk of capital loss and diminishes the potential for future gains. Conversely, purchasing undervalued assets at reasonable prices provides a margin of safety and enhances the likelihood of achieving favorable returns over time. By focusing on true valuation and exercising prudence in their investment decisions, investors can mitigate the risks of speculative bubbles and position themselves for sustainable long-term growth.

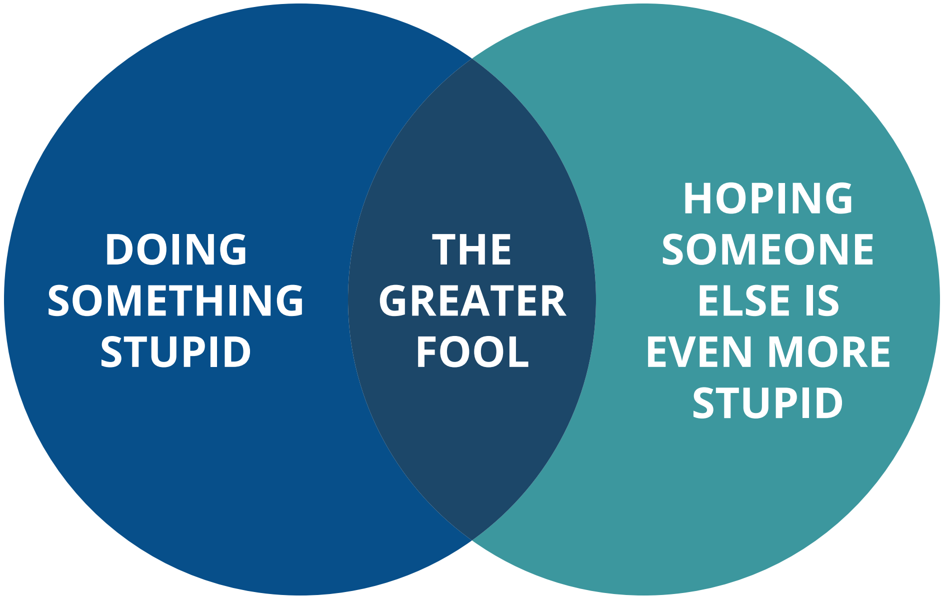
The natural cycle of markets is ebb and flow, bubble and burst, feast and famine; recognizing that the incumbent powers that be are ephemeral, no matter the seeming momentary superiority of service, product, or experience, is to understand what drives human behavior and markets, which are not reality per se, but a shared sense of anticipatory expectations.

Credit: Dominic Godbout FLICKR

REMEMBER BEANIE BABIES?

"That the speculative episode in Beanie Babies took place in tandem with the Internet bubble suggests that the cultural forces that were alchemizing Internet stocks had the same effect on Beanie Babies. They rose in an era of unreality defined by magical thinking; as economist Dr. Robert Shiller writes in Irrational Exuberance: 'Speculative market expansions have often been associated with popular perceptions that the future is brighter or less uncertain than it was in the past.'"

https://www.wbur.org/hereandnow/2015/03/02/beanie-baby-bubble



At its core, value in economics can be broken down into two types of models: The Greater Fool model and the Intrinsic Value model.

The Greater Fool model suggests that the price of an asset can be justified by expectations that someone else, will eventually be willing to pay an even higher price for it. In other words, it's the belief that one can profit from buying overvalued assets simply because there will always be someone else willing to pay an even higher price for them in the future.

With the Intrinsic Value approach, investors base their investment decisions on the fundamental value of assets rather than relying on expectations of finding a greater fool. They analyze factors such as earnings, dividends, cash flow, and other fundamental indicators to determine the true worth of an asset. Investors using this model typically have a long-term perspective, seeking to invest in assets that are undervalued relative to their intrinsic worth and holding onto them until the market recognizes their true value.

Blowing Bubbles

The next major industry, even the next leap in evolution in our public lives, may lie in fostering a shared illusion through VR or other more-interconnected media; it may not. Its staying power and commercial viability will be based on how valuable we decide it to be. Perhaps the next major shakeup in the fabric of our lives is yet to be introduced, or has been under our noses in some form or another for far longer than even smart phones.

The important thing to keep in mind is that once something is determined to have value by a large amount of consumers, it becomes valuable, and then everything changes. But such a rise sows the seeds of any fall. For investors, the challenge lies in discerning the contours of these shifts before they take root: understanding the timeworn patterns of adoption, innovation, and eventual obsolescence. It's not about resisting the growth, but about tending the financial garden with care, cultivating a strategy that weathers both the bloom and the wilt, so you're prepared to nurture and harvest what endures when the next season inevitably arrives.

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Endnotes

[1] Only notable for the lack of written attestation of exactly when the tulip became a point of aesthetic focus.

[2] https://www.smithsonianmag.com/history/there-never-was-real-tulip-fever-180964915/

[3] A historical unit of measurement, roughly equivalent to about 1600 kilograms (approximately 3527 pounds) of wheat.

[4] One hogshead would be equivalent to about 63 gallons (approximately 238 liters).

[5] One tun would be equivalent to about 252 gallons (approximately 954 liters)

[6] Tulip breaking virus (TBV), which can also affect lilies.

[7] To put it very briefly, the Thirty Years' War (1618-1648) was a devastating conflict primarily fought in Central Europe and involving the main European powers of the day, including the Holy Roman Empire, Spain, France, and Sweden. It was sparked by religious and political tensions, leading to widespread destruction, famine, and population loss.

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