

That stock markets are disconnected from reality is bec...

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The US stock market, as reflected by the S&P500 index, reached an all-time high yesterday. [According to the FT](#):

The S&P 500 index briefly rose to a high of 3395, eclipsing the previous record that was reached in February before coronavirus fears gripped the market.

They added:

The barometer has soared 54 per cent since the low on March 23, fuelled by central bank and federal government stimulus, with the gains being led by America's biggest technology companies including Apple, Amazon, Microsoft and Google parent Alphabet.

But it is curious that in the same email that delivered this news there were other headlines that cast doubt on the relevance of this:

Norway's oil fund fears market disconnect from real economy
Concerns raised after \$1tn sovereign wealth fund records second-best quarter

Investors increasingly unsettled by 'overvalued' markets
Fund managers are upbeat even as they fret about prices of stocks, bonds and gold

Yield-starved investors start to rummage in triple C-rated debt
Fund managers plumb the depths as rally squeezes returns on higher quality bonds

It's no secret to long time readers of this blog that I have long felt that the connection between stock markets and reality disappeared many years ago. It's good to note that many, if not most, serious investors might now agree, even if the market algorithms that now drive so much investment still drive the herd along despite the obvious failure within the logic that results in this illogical behaviour.

I am pleased to see that my old friend Larry Elliott agrees. In one of his best articles that I might have ever read, he was in damning form in [The Guardian](#) saying:

The rapid bounce in stock markets helps to give the impression that everything is under control and the economic crisis is drawing to a close. Traditional wisdom has it that share prices anticipate events so rising stock markets reflect the fact that the world is on course for a rapid recovery that will see life return to normal in 2021. This might be true for the high net-wealth individuals invested in hedge funds. For almost everybody else, it is nonsense on stilts.

Larry is right. What we have got is a stock market that is utterly disconnected from a number of realities.

The first of these is the reality that such markets fund business, because they do not now. Stock markets raise very little new capital for business and all serious business investment is now funded by debt.

The second follows on, and is the claim that stock markets appropriately allocate capital to markets. If they did the current disconnect could not happen.

The third is that stock markets reflect underlying value, which is very obviously untrue: when the world is heading for the most severe recession for more than a lifetime this cannot be the case.

The fourth is that markets are efficient, which is only now true if you accept that they efficiently reflect the massive amount of financial support that they enjoy from governments, which is the sole reason why they have recovered as they have.

And fifth, the reality that says that these markets are important (as maybe once they were) should also be consigned to history. I long for the day when the BBC stop reporting movements in the stock market almost every hour as if it matters. It does, but only if you think the results of the 3.15 at Kempton are also worthy of being reported in the same way.

The simple fact is that nothing markets have done, and nothing that those companies quoted on markets have done, has in any way given rise to this record valuation. It has actually arisen because the US government has bailed out markets because Trump thinks that the S&P500 is essential to his popularity (which claim is also wrong). As a consequence vast amounts of Federal support has produced this outcome.

But as Larry asks:

If low interest rates and QE don't lead to investment in productive enterprises, is there anything to prevent governments from bypassing the financial system and investing itself in things like green infrastructure? Not really. Central banks say this would undermine their independence by getting them into the world of political decisions, but this suggests that steps taken to boost asset prices are not political decisions, which of course they are.

Or to put it more bluntly, central bankers and the politicians on whose behalf they act are already lying through their back teeth when they say they are not already picking winners and losers in our economies and societies, which they are actually doing day in and day out.

They choose to support markets.

They will very soon be choosing not to support employment.

Or smaller businesses.

Or a Green New Deal.

Or an economic recovery.

And that's because none of these things matters to the high net-wealth individuals invested in hedge funds who central bankers and populist politicians spend much of their lives mixing with.

That stock markets are disconnected from reality is because our politicians, our central bankers and our financial elite are also wholly disconnected from that reality.

My question is, how long can that last? This is a recipe for instability, and I think it might happen.