Wall Street: When the magic of the marketplace dies

by Joyce Fredman

Although a large number of people have heaved a sigh of relief that last October's crash has come and gone and the market appears to have stabilized, truth to tell, the market no longer exists. Trading over the past year has been at less than breakeven levels, and the amount of new capital is negligible. The pieces of paper that have exchanged hands, the numbers that have appeared in computer terminals, are nothing more than a mickey show for the gullible. Following the ups and downs of the Dow Jones Industrial Average is not only an exercise in futility; it is an activity for the clinically insane.

As opposed to the way most normal people react to world events, the fellows who live in "the market" revel in disaster. Is there a war likely to occur in the Middle East? Well, that's terrific news for the traders, the oil prices will skyrocket. Is the coal mining industry falling to pieces? That's a splendid opportunity to buy out one of the companies and dismantle it. Are people dying in Africa? It will be a piece of cake to go in and snatch up their strategic minerals.

Contrary to Aristotelian logic, this in no way implies that the converse is true. Just because the physical economy is developing productively is no guarantee that the market takes a dive. In fact, these people are, for the most part, in no way connected to actual events. Rather, they have created an extremely autistic circumstance. Wall Street has removed itself so far from the real world that it has become encased in a mire of imaginary games for which there are no winners. Black Monday was assured by the nature of the activity in which these fools engage. The $750 billion bath that Wall Street took was the consequence of years of playing in dirt.

However, the kinds of games that are being played have come to the public's attention. Enough attention was drawn, in fact, to cause more than a few cautious investors to drop out of the market. More than 16,000 jobs have been lost in the securities "industry" because of the decline in trading volume since last year. Another 10,000 jobs are expected to vanish in the next few months. The industry's pre-tax income in the second quarter was down 50% from first-quarter levels, and a 30% drop for the third quarter is predicted.

With the volume of trading at less than 120 million shares, the brokerage houses cannot break even. But even the 120 million figure is deceptive. A large proportion of shares being traded can be attributed to what is called "dividend capture." This peculiar mechanism allows for the transfer of stock back and forth between the same two parties, stopping in the purchasers' portfolios only long enough for them to be paid a dividend. Quite often, the transaction takes less than a day. Hence, the shares are double-counted as they go back and forth. Yet, even this inflated volume is still not enough.

There have been at least 10 securities' firm mergers announced or completed since the crash, and more are on the way. The amount of new capital that American corporations raised on Wall Street has shrunk by nearly $24 billion so far this year, a 10.3% decline, to $205.7 billion, compared with $229.2 billion for the same period last year. In the last nine months, 161 initial stock offerings worth a total of $4.2 billion were brought to market, compared with 475 offerings worth $13.4 billion in the nine months previous to the crash.

These statistics have left John J. Phelan, Jr., chairman of the New York Stock Exchange, undaunted. Admitting that "a significant retrenchment" is a good possibility, he is nonetheless cavalier. "You have to let markets expand and innovate. The price to be paid is the accident that comes up." As it is the U.S. population that ultimately pays the price for these accidents, it would be interesting to know exactly what this expansion and innovation is that Mr. Phelan and his ilk are talking about.

Arbitrage and insider trading

Arbitrageurs, the traders who often buy stocks of takeover targets in expectation of higher prices, have grabbed headlines over the past year. This is due in large part to the increasing number of hostile takeovers that have occurred. The inability of the stock market to manifest any yields of its own means that it must look elsewhere for income. More and more companies are now vulnerable to a process which turns over fast cash.

The arbitrageur usually takes the company apart, strips assets, and sells its components to finance the takeover, despite any ramifications for the company's previously useful production. Some companies have become easy prey, not because of their difficulties, but because they have made substantial capital investments in modernizing their technology or built up their pension funds. Their immediate cash shortfall because of such decisions renders them unable to fight any takeover. The arbitrageur is able to make money by destroying such investments, i.e., creating money based on nothing.

Another way an arbitrageur can create an illusion of value is by index arbitrage. This is done by computer programming. When there is a sufficient difference in the present stock price and the futures market for that stock, the computer automatically initiates sell or buy orders to realize the difference. Again, money is created solely on the basis of an exchange of paper.

(Whole committees, set up in Congress to determine exactly what happened during the crash, have spent days on end trying to figure out the implications of this process. The involved and contradictory conclusions reached by these taxpayers' servants would fill volumes. The joke is—as even

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FIGURE 1
New York Stock Exchange
Daily trading volume

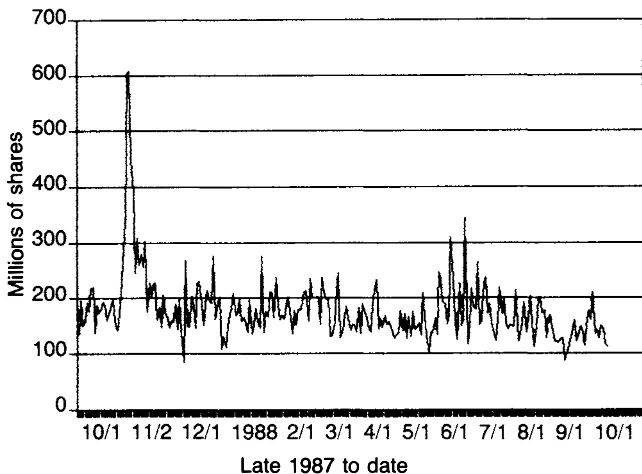


FIGURE 2
Tokyo Nikkei

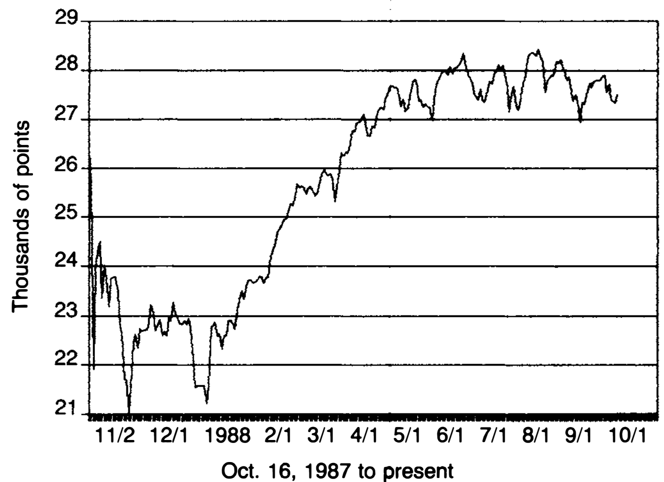
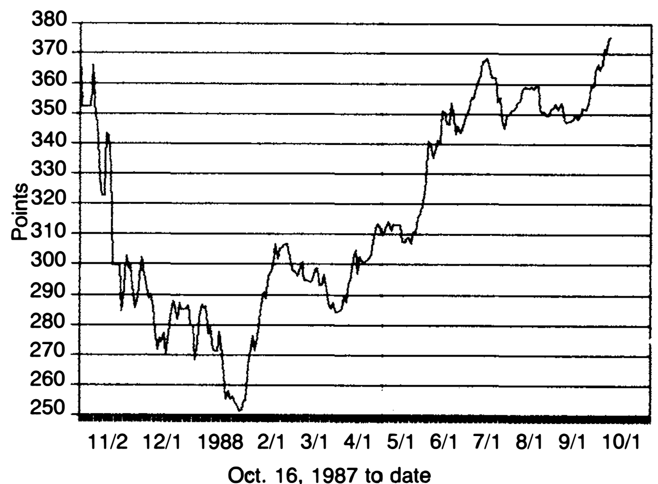


FIGURE 3
Paris Stock Exchange



the stereotype character in Hollywood's version of "Wall Street" figured out—that there is, in fact, nothing going on; it's an expensive optical illusion.)

The slippery side of these manipulations has come to be known as insider trading. Insider trading is generally defined as buying or selling stocks on the basis of non-public information that could affect stock prices. It vaguely refers to trading by those in a position of responsibility—directors, officers, investment bankers, or anyone with access to inside information, legal or not.

As the whole system of trading is based on the passing of information, the recent allegations of illegal activity have raised doubts in many people's minds as to the sincerity of the prosecution. The General Accounting Office recently conceded that, after a number of people had been convicted, a legal definition of insider trading might be in order. The idea of defining a standard of ethics for a group of people whose most successful role model, Ivan Boesky, stated, "Anyone who thinks that greed is a bad thing, I want to tell you it's not a bad thing. And I think that in our system, everybody should be a little bit greedy . . . you shouldn't feel guilty," is a contradiction in terms. The fact that Boesky was exposed does not detract from his enunciation of the motivation behind all these activities.

Junk bonds

Junk bonds are defined as non-investment grade, high-yielding securities that are considered speculative or risky. By definition, the interest rates are substantially higher. That determination is made not on the value of the enterprise, but on the uncertainty of its future. In other words, the moguls of Wall Street decide, based on their various swindles, what the future holds in store for any company, and whether or not it merits an investment grade. Therefore, even such vital segments of the community as hospitals and utilities, have been relegated to the junk bond heap. They are forced to pay usurious rates in order to stay in existence.

On the other hand, the junk bond market is hardly exclusively worthy causes. It has received its notoriety for being a laundering network for dirty money. When junk bond whiz kid Michael Milken, along with others from Drexel Burnham Lambert Inc., were charged with fraud and securities violations, a whole filthy apparat was exposed.

"Israeli mafia" Miami financier Victor Posner was one of those charged. He is well known for his association with the

FIGURE 4
Frankfurt Stock Exchange

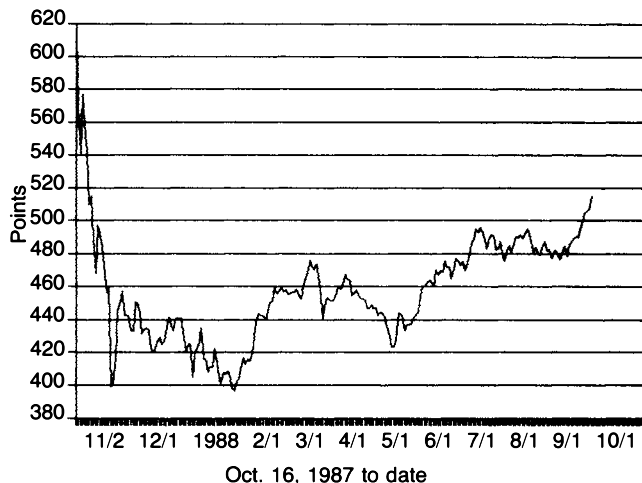


FIGURE 5
Zurich Stock Exchange

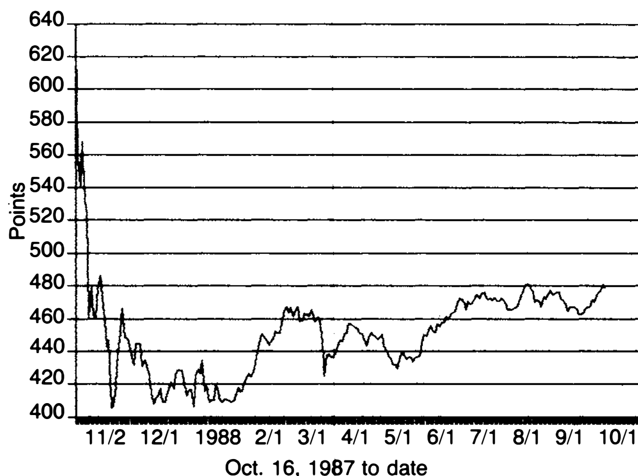
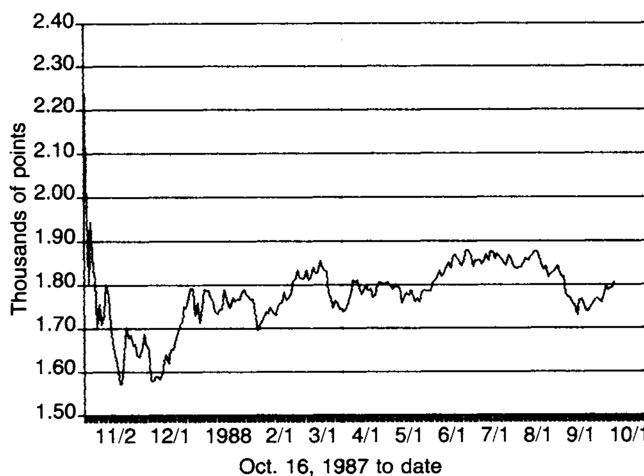


FIGURE 6
London FT100



late Meyer Lansky, a reputed mobster. Posner's friend Milken has some questionable associations of his own.

Milken, who claims to have learned his appreciation of high-yield, high-risk securities at the Wharton School, has a personal fortune of over $500 million, including the largest individual holding of Drexel itself. He works out of an office at Wilshire Boulevard and Rodeo Drive, in Beverly Hills, California, which is shared and used by Meshulam Riklis, owner of Rapid American Corporation. Riklis is a well-known pornography kingpin, degraded enough to star his child-bride, Pia Zadora, in his blue films. U.S. Customs Service sources report that Rapid American Corp. has been number one on their watchlist for drug-smuggling across the U.S.-Canadian border since the mid-1970s. Riklis was also a major owner of the Investors Overseas Services scam in the late 1960s until he sold out to Robert Vesco.

Another colleague of Milken and Riklis is Saul Steinberg, chief executive officer and chairman of the board of Reliance Group Holdings Inc. More than 40% of Reliance's fixed-income portfolio of $4.5 billion came from junk bonds in 1987. In 1984, Steinberg staged a raid on Walt Disney Productions with Drexel's junk bond financing. Although the raid itself was unsuccessful, Steinberg netted over $32 million in greenmail profits. (Greenmail is the payoff to the raider to back off.)

Steinberg himself does not seem to have a lot of character references. In 1980, during divorce proceedings, his estranged wife filed a stockholder's suit against her husband, charging him with being "a heavy user" of narcotics who "as a consequence of his drug addiction . . . failed to attend many corporate meetings and to perform certain corporate duties." According to *Fortune* magazine, he paid out $190,000 in company funds for illegal drugs including cocaine. He was also accused of using $100,000 in corporate money to bribe a New York City official to win a construction contract for one of his cronies.

Despite the protestations of the Securities and Exchange Commission, there is a fine line between the practices and clientele of the junk bond market and the practices and clientele of the overall market. The SEC alleges, in cases like Drexel, insider trading, price manipulation, falsifying records, rigging takeovers and cheating clients. Such charges are most likely quite accurate and definitely ought to be prosecuted. The charges simply have not been leveled at enough people.