Dow Jones: Nation's 'top indicator' indicates nothing

by Anthony K. Wikrent

U.S. political prisoner Lyndon LaRouche said on Aug. 17, "It is apparent that this week is a crucial point of inflection in international financial markets. This is *part of,* if not *the* turning point in the economic situation, the monetary situation. . . . I indicated, in my next-to-last forecast, back in spring-early summer of 1989, that the Anglo-American markets, and the international monetary system, would go into a crisis, probably—that is, with a 95% probability—somewhere between October of 1989, and about April of 1990. In fact, it did go into such a crisis, but some of the implications of the crisis were masked in the news reporting, by virtue of the various kinds of circuit breakers put into the system. The bailout efforts with the circuit breakers masked somewhat, from the standpoint of reporting in financial markets, the degree of crisis which actually did occur during that period."

Since July 17, 1990, the day the Dow Jones Industrial Average peaked at 2,999.75 points, the world's major stock markets have dropped precipitously. The Dow has collapsed 17%, the Tokyo Nikkei 28.5%, the Frankfurt and Zurich markets about 20%, and London has slipped over 10%. The slide in the markets is obviously being precipitated by the Gulf crisis, but it had to come sooner or later, as a distorted reflection of reality: The physical economy of the United States has been in a depression since at least 1982.

How, then, have the financial markets been made to appear that such is not the case?

The new, deregulated stock market

Unlike 30 or 40 years ago, U.S. financial markets today are dominated by large institutions, able to deploy billions of dollars into such arcane procedures as index arbitrage, and to execute trades involving tens of thousands of shares with market values of hundreds of millions of dollars. The large brokerage houses, such as Morgan Stanley, Goldman Sachs, Salomon Brothers, or CS First Boston, have become major market makers, rather than mere agents for those desiring to sell or buy stocks; they now derive 20-40% of their profits from trading for their own accounts. These houses have developed sophisticated computer programs for "program trading," the purchase or sale of a *group* of stocks—often hundreds at one time—rather than an individual stock. During a typical day on the New York Stock Exchange, about 10% of the volume is done by program trading.

Thus, U.S. financial markets are no longer the vehicle by which capitalists raise capital by selling shares of ownership to the public. Nineteen years of financial deregulation have allowed monstrous concentrations of wealth to displace individual investors. In 1975, only 26.6% of the total shares traded on the NYSE involved transactions of 5,000 or more shares, while 42.1% of all trades involved transactions of 100 to 900 shares. By 1980, this ratio had been reversed, with 43.1% of NYSE trades involving transactions of 5,000 or more shares, while 24.7% of all trades were of transactions of 100 to 900 shares. In 1988, fully 67.6% of all NYSE trades were transactions of 5,000 or more shares, and only 13.6% were transactions of 100 to 900 shares. Morgan Stanley's computerized trading programs alone determined 3 of every 100 shares traded in the first three months of this year.

Very few individuals can afford to own, let alone trade, 5,000 or more shares of any stock traded on the NYSE. The individual investor normally trades far below 500 shares. Many trade less than 100 shares, which is known as "odd lot" trading. In 1970, odd lot trading accounted for 5.95% of all trades on the NYSE, but by 1980, it accounted for only 1.81%. In 1988, odd lot trading was just 0.65% of the NYSE volume.

There is an essential difference between investing and trading. As the forces that dominate the stock market focused less and less on ownership of a particular company's stock, they began to focus more and more on short-term speculative gains via any number of financial manipulations. The most notorious has been index arbitrage, wherein computer programs are used to "capture" the difference in price between a "futures contract" to buy or sell certain stocks at a specified price at a specified point in the future, and the actual price at which those stocks are trading on the stock market. One of the few things that seems to make any sense when one looks at U.S. financial markets today, is the assumption of index arbitrageurs that the price of a futures contract ought to be closely related to the prices of the real stocks on which it is based.

A speculative bubble

For example, on July 23, when U.S. financial markets were hit in the first half-hour of the day with heavy selling by Salomon Brothers and Goldman Sachs—supposedly on behalf of European clients—the two firms "soaked up a lot of selling pressure" by purchasing about 450 Standard and Poors 500 futures contracts at $178,900 per contract, according to accounts by traders at the Chicago Mercantile Exchange that appeared in the *Wall Street Journal* the next day. The *Journal* noted that if Salomon and Goldman bought the contracts for their own accounts and held them until the close of trading, Salomon made $750,000 and Goldman Sachs made $450,000 in that one day.

The particular contract mentioned above—the S&P 500—is an index futures contract, and its very name is a good indication of why such financial futures have even less connection to reality than the stock markets. The owner of a futures contract does not own anything that has to do with any particular company. The S&P 500 futures contract is essentially a wager that the S&P 500 index, computed from the individual stock prices of 500 companies, will be at a certain level at the specified date. It is nothing more or less than elaborate gambling.

At over $100,000 for a single contract, the futures markets are almost exclusively the preserve of large, well-funded institutions. The value of financial futures traded is now over 150% the value of the underlying stocks traded. According to Kurt Brouwer, of Brouwer and Janachowski in San Francisco, $230 billion in equity holdings, or 10% of the NYSE, is now indexed.

The Wall Street lemmings

This brings us to the absurdity of measuring the well-being of the financial markets—and the U.S. economy—by using the Dow Jones Industrial Average. Assume that traders on the floor of the NYSE are manically engaged in a market selloff. As the different traders seek desperately to unload their holdings before "the bottom falls out," they accept lower and lower prices at which to sell. Stock prices plummet. The market indicators—such as the DJIA (which is comprised of only 30 stocks) or the S&P 500—also plummet.

Whatever has touched off the selling frenzy in New York—whether a new corporate bankruptcy or news that George Bush was force-fed broccoli by an enraged pensioner—is expected to be reflected in the behavior of the financial futures, the most popular of which are traded on the Chicago Mercantile Exchange and the Chicago Board of Trade. Remember that financial traders no longer pay much attention to individual companies. Traders now search out and seek to exploit *trends*. The bankruptcy of a single big company might start the trend of its many creditors also going bankrupt.

But what happens if, instead of collapsing, the price of financial futures contracts begins to rise? Traders in New York will look at their screens reporting such action in Chicago, and begin to fear that their selling may have been based on incorrect information or a mere rumor; that there is no new "trend."

Since the margin required to buy a financial futures contract averages only 7% compared to 50% to buy actual stock, a relatively small amount of money can create quite a large impression. It does not matter that the DJIA reflects the price movements of only 30 of the over 1,600 issues traded on the NYSE: The DJIA is a very convenient indicator of a trend. There have been repeated reports that when the markets have begun collapsing, the federal government, acting through a select group of brokerage houses, such as Morgan, Salomon, and Goldman Sachs, has purchased enough stock index futures contracts to drive up the market indicators, causing stock traders to doubt the veracity of the information on which they based their decision to sell. A new "herd mentality" is thus created, and traders await further developments rather than sell. Moreover, market authorities now impose "circuit breakers": When a particular index falls too rapidly, the relevant futures contract is simply not allowed to trade at a lower price for a period of time.

According to reports, the vehicle the government most likes to use for its forays away from the "free market" is the Major Market Index, comprised of only 20 stocks, 17 of which are on the DJIA. "It's the most convenient way to move in and out of the market fast," observed Kurt Brouwer.

If it weren't for the fact that all these gimmicks have masked the reality that the real U.S. economy has become a heap of scrap, the ease with which the herd mentality of the traders can be directed and manipulated would be merely amusing. As David Bostian, an independent Wall Street analyst, observed of the 76.74 DJIA point sell-off of Aug. 23, "It's the classic herd instinct. No one anticipated the market going down, but the Gulf crisis changed all that. They're all wondering what's going to happen next. It's an amazing phenomenon: They're paid incredible sums of money to act like a bunch of lemmings."