The psychosis of the markets

by John Hoefle

The message suddenly popped up on the trader's screen: FidoFeast.com, the fledgling Internet dog-food delivery company, had just issued a press release stating that only three months after going public, it finally had its first customer. The trader knew he had to act fast, so he quickly bought 30,000 shares of FidoFeast, and began stalking his screen. Within a minute or two, he knew, the news he got so quickly on his special high-speed terminal would hit the Internet, and others would begin to buy. Sure enough, about four minutes after he placed his order, Fido's stock jumped up one-sixteenth of a point. "Yahoo!" the trader yelled, as he entered his sell order.

In less than five minutes, he had jumped in, jumped out, and pocketed several hundred dollars in profit. That the trader knew virtually nothing about FidoFeast.com, mattered little. Whether the company was viable or not, was irrelevant; even if it disappeared tomorrow, so what? He was not concerned with such issues. He was concerned with making money, and he had. This wasn't a long-term relationship, but a five-minute stand. Who cares about the rest?

While the above trade is, at least as far as this author knows, fictional, the process it describes takes place thousands of times a day in dozens of day-trading offices across the country, and in thousands of homes and businesses.

Day trading

According to the Electronic Traders Association, there are some 3-5,000 people who are full-time day traders, and another 225,000 people who trade part-time over the Internet, with day traders accounting for some 8-15% of the daily volume on the NASDAQ stock exchange. Since the rise of the Internet frenzy in 1995, the NASDAQ has surpassed the New York Stock Exchange in trading volume, with daily trading volume now routinely exceeding a billion shares, and much of that volume is due to trading in volatile Internet and technology stocks.

Day trading, as even many of its proponents admit, is not investing (neither is most of what is called investing these days, but we'll get to that later). Day traders typically hold a stock for a few seconds or a few minutes, taking advantage of small movements in price. To make any significant profit on changes of one-sixteenth to one-eighth of a point, the traders have to buy large blocks of shares, and to earn a living trading full time, they have to make a lot of trades. The average day trader, according to a study by NFO Worldwide, makes about 260 trades a year, some 11 times the activity of the average on-line investor; but some traders are much more active, at times making more than 100 trades a day, according to the day-trading firm Momentum Securities.

A whole subculture has grown up around on-line trading, with Internet web sites and chat rooms devoted to stock trades, tips, discussions, and rumors. In this virtual-reality world, rumors which are not true are as good as rumors which are, as long as they make the stock move.

On-line trading has become big business, attracting even the largest brokerage firms. Individuals can trade stocks over the Internet, paying as little as $8 a trade in commission to their broker, while really serious traders can sign up with a day-trading firm.

Day-trading firms make their money by setting up trading rooms across the country, providing banks of high-speed computers and data links. They rent these trading stations out to individuals, and charge a fee (typically $25) for each trade. Since the more trades the customers make, the more money the firms make, some firms provide free lunches to their traders. Anyone who has been to a casino knows the drill: Keep the sucker at the table at all costs, since you only make money while he's betting.

To make money off small movements in stock, as we said, requires placing large bets. For example, take a day trader who buys a stock, and then sells it when it goes up one-sixteenth of a point (called a "teeny" in the jargon of day traders). To make one dollar of gross profit, the trader would have to buy and sell 16 shares, and to cover the $25 commission, the trader would have to buy and sell 25 times that amount, or 400 shares. Thus, for a stock selling for $50 a share, the trader would have to buy and sell $20,000 of stock just to cover the commission; to get an after-commission profit of $100, the trader would have to buy and sell $100,000 in stock. To make a $100 post-commission gain on a stock selling for $100 a share, the "teeny" trader would need to buy and sell $200,000 in stock.

But what if the trader guesses wrong, and the shares fall? On the 2,000 shares the trader would buy to make that $100 after-commission profit on a "teeny" bump in the price, the

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trader would lose $125 if the stock dropped one-sixteenth, $250 if it dropped one-eighth, and $500 if it dropped one-quarter point. And, he would still have to pay the $25 commission on the deal.

With such large dollar volumes of stock required to play the game, day traders often place bets on margin. Margin betting can be lucrative if the trader wins his bets, since it enables him to buy more stock than he would have been able to buy otherwise, but it can be deadly if he loses. On a losing bet, the trader not only loses money on the trade, but he also has to pay the margin call.

Like the compulsive gambler who attempts to dig himself out of a hole by placing ever larger and wilder bets, a day trader can quickly lose huge amounts of money, finding himself broke and heavily in debt.

That day trading is more a form of gambling than investing, is rather widely known, and little admitted by both financiers and regulators.

"Some argue day trading is really nothing more than speculation," Securities and Exchange Commission Chairman Arthur Levitt noted in a speech to the National Press Club in Washington, D.C., on May 4, 1999. "Personally, I don't think day traders are speculating because traditional speculation requires some market knowledge. They are instead gambling, which doesn't."

The system is nuts

While we would certainly agree with Mr. Levitt that day trading is gambling, we cannot agree with his implicit claim that "traditional speculation" is not. In fact, what the day traders are doing, is basically the same thing that Wall Street does, with a couple of major differences.

The first major difference is that Wall Street by and large places its bets with other people's money ("OPM," in the jargon), whereas day traders bet their own money. If a Wall Street firm bets wrong, they may "blow up" a customer or two, but the firm remains.

The second major difference is that if a big Wall Street firm gets into trouble, the Federal Reserve will bail it out.

Other than that, the only real difference between the day trader and the typical Wall Street trader is the size of the bets being placed. Day trading is just the extension of the Wall Street trading-room model down to individuals.

For proof, one need look no further than the derivatives markets. Take Chase Manhattan, for example. As of March 31, 1999, Chase Manhattan Corp. had $361 billion of assets on its balance sheet, and $10.7 *trillion* in what the Federal Deposit Insurance Corp. calls "off-balance-sheet derivatives." That is, for every $1 on its balance sheet, it had $30 in side bets in the derivatives markets. The top four U.S. commercial banks (Citigroup, BankAmerica, Chase, and J.P. Morgan) had among them $1.9 trillion in assets, and $31 trillion in derivatives bets, or $16 in bets for every dollar of assets.

This, presumably, is the "traditional speculation" which Mr. Levitt defends.

On a global scale, there are some $300 trillion or more of derivatives and related financial claims outstanding, against some $20 trillion of annual global productive activity. The financial claims, already unpayable, are growing at a rate of 70% a year or so, as current unpayable claims are constantly being rolled over into newer, larger, and more unpayable claims. At the same time, the productive end of the economy is rapidly shrinking. With every day that passes, the global financial system slides deeper into bankruptcy.

Mass psychosis

The entire world is, in fact, sliding deeper into depression every day, and as it does, the world becomes a more and more hostile place in which to live. The Kennedy vision of a world in which a rising tide of economic progress lifted all boats, has given way to a Hobbesian each-against-all world in which individuals are forced to battle each other, to avoid being thrown out of the overcrowded lifeboats.

In such an environment, it is inevitable that some people will snap: Some will kill, either themselves or others, some will more quietly go insane, some will cower, and others will turn into vicious predators.

The headlong rush into gambling, be it in the casinos, the markets, or the state lotteries (the lotteries being the poor peoples' derivatives markets), reflect the growing level of desperation among the population. More and more people see the "big score" as the only way out.

But even the "big score" is an illusion. The lottery winners who think that they will collect that "$1 million a year for 20 years" will never see it. The stock market winners who think their big portfolio will last are likewise deluding themselves. None of it is real, and none of it will survive the looming crash.

Perhaps the biggest myth going these days, is the myth of the "free market." The financial markets have always been manipulated by the financial oligarchy from behind the curtain; but now, as the system nears its end, that manipulation has come increasingly out in the open. The "rescue" operation mounted by the major central banks last fall to stop the financial system from melting down was a giant manipulation of the market, transferring huge losses from the (off-)balance sheets of the big banks and hedge funds, to taxpayers and other suckers. Today, the manipulations are even larger, driving the yen this way and the euro that, in a vain attempt to paper over huge derivatives losses, to keep the system going a little while longer. Meanwhile, the oligarchy is abandoning ship, buying up control of the world's precious metals, strategic minerals, food supplies, and other necessities of life, to increase their power in the post-crash world.

For all its horror, what happened in Atlanta is just a drop in the bucket compared to what is happening worldwide, and just a preview of what is to come, when the crash hits.