THE DANA VIEWPOINT

# RISE OF THE MACHINES

*May 11, 2010*
*Dow: 10,799*

It couldn't be more futuristic. Last Thursday's meltdown on the New York Stock Exchange (NYSE) had all the earmarks of man vs. machine. All the exchanges now use electronic trading. However, the NYSE uses a hybrid model that shuts down computers when trading gets too volatile and hands it over to humans to slow things down. The rest of the computerized exchanges kept trading and the result was a Dow Jones Industrial Average that plummeted one thousand points in a matter of minutes. Sanity returned (somewhat) and the market recovered most of the loss. Human floor traders are charged with maintaining an orderly market, and for the most part they have done a great job over the years. Obviously the current system needs to be tweaked. For one thing, the Securities and Exchange Commission (SEC) should bring back the up-tick rule that allowed selling a stock short only on an up-tick. Back in the 1920s, cartels of sophisticated investors would get together and short a stock and drive the price down unmercilessly and then cover their shorts at a huge gain. The SEC was formed in the early 1930s to regulate trading and one of the first rules they established was the up-tick rule stating that you could only sell a stock short on an up-tick in price. They repealed this rule in 2007 and this could only have added to Thursday's volatility. Machines may have risen up once again and bit us in the butt. We live in a highly complex world where information travels quickly and reaction to news is even quicker.

So, what about the stock market? The market was up 82% from its low on March 9, 2009 and a pause was in the cards. And right on time, as the market was ready to correct, the news came out to justify the pause. That would of course be the financial crisis in Greece. The Gross Domestic Product (GDP) of Greece represents only 2% of the total GDP of the European Union so this would not appear to be a major problem. The real concern is that the crisis could spread, most notably to Spain and Italy. This is possible, but the financial structure of the world is much improved since 2008 and should be able to withstand any further contagion. All of a sudden the US dollar looks attractive what with the Euro dropping. A collapse of the Euro would not be healthy, however. The crisis in Greece, including the rioting, should be a wakeup call to nations trying to spend their way out of a recession. Worldwide,

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nations need to come to grips with their debt. The good news in the US is that corporations and consumers are cleaning up debt problems and are poised to take advantage of the economic recovery. In short, think correction in stocks, not primary bear market.

This just in: European leaders agreed to provide $1 trillion in aid to help contain the debt crisis in Europe. This includes government backed loans and 250 billion Euros from the International Monetary Fund (IMF). About 20% of the money in the IMF comes from the US. In addition, our Federal Reserve announced plans to funnel US dollars to the European Central Bank (ECB). The Fed did this in 2007 during the financial crisis. The program was suspended this February and will now be reopened. The Fed feels secure with the program as central banks are on the hook, not commercial banks. Nevertheless, we continue to reward bad behavior. The bad news is that these trillions of dollars in bail-outs is money that will no longer be available for economic growth. Monday, after the deal was announced, the long-term borrowing costs for Greece dropped from 12.4% to 6.5%. Germany's rates (they supplied most of the bail-out money) rose. Something is not right here. The solution appears obvious – cut spending and reign in entitlement programs. Will that happen? Well, there certainly is political upheaval around the globe today and most of it is aimed at governments and political leaders. Hopefully, these movements will generate some positive change. Stay tuned.

Turning to more mundane economic news, non-farm employment increased 290,000 for the month of April. Over the last three months the economy has added 573,000 new jobs. So why did the unemployment rate jump from 9.7% to 9.9%? Unemployment numbers do not take into account people who are unemployed but not looking for work. When there are signs that the economy is improving and companies are hiring, these people enter the job market and we have more people looking for work. In addition, part-time workers start looking for full-time jobs. Sort of a Catch-22.

**Random Thought for May 2010:** "You can always count on Americans to do the right thing – after they have tried everything else."

*Winston Churchill*



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