

June 2010



“Sell in May . . . “

A heckuva month since I last wrote to you. Among market-inspired aphorisms ('wall of worry', 'buy low, sell high'. . .) you'll find 'Sell in May and walk away'. Last year not so much . . . this year Big Time. Remember my indicator? It had peaked above 80%, a rarity. Today it reads 40%, one of the largest drops ever. The Dow Average also had one of its worst Mays since 1940. Such radical numbers almost by definition defy explanation.

Let's review. The market had a very good run for about a year. The perceived strengthening of US and world economies, together with a significant earnings rebound, boosted stock market averages everywhere. Recently, the pace has slackened, increases limited to a smaller group of stocks, with many stocks deteriorating while the select group increases. This 'narrowing of the market' is a typical indicator of a bull market losing its vigor. Add a threat or two—think: Greek debt crisis—that could derail the recovery and you observe a market with the jitters, prone to excitement and then retreat.

Need another factor? You got it last Thursday. Technology run amok. For reasons still not clearly understood, the market shed 1000 points in about 45 minutes. It seems some trader hit an extra key and vastly increased the size of a sell order in Proctor and Gamble. To accommodate such a sale, the price of P&G had to be reduced a lot, causing an immediate drop in the Dow average—maybe 250 points. Watch out! A drop of that size in that short a time triggered the electronic trading programs to sell and sell they did because that's what they are programmed to do. When, finally, the glitch was discovered, the market reduced its loss for the day to around 350 points. Still, not a good day.

The day's activity underscored some serious market weaknesses, e.g., the jitters of all participants, willing, *dieing*, to sell at any sign of trouble. Call that normality on speed. Second were the electronic trades, which account for as much as 60-75 % of the markets' volume on any day. This is not me calling on your behalf to sell a hundred of this or buy a hundred of that. These monster trades are designed to take advantage of any movement in the markets, with the effect that they can and do influence the shape and magnitude of such movements, for good or ill. The third and possibly most serious problem revealed was the lack of liquidity. Our markets are designed to process buy and sell orders quickly and without much price movement. In normal times an order for \$3 million in one index would all trade within a couple cents of the last trade. On Thursday, between 2:15 and 3 pm., when the market trading structures had broken down, orders were executed for as little as zero cents, bizarre enough that the exchanges had to cancel some trades on the grounds of absurdity.

If traders—let alone computers—have a case of the jitters, shouldn't we, too? On the world stage, when a credit crisis over *there* may precipitate a credit crisis over *here*, isn't it a sign of sanity to be afraid? Answer: Yes. Some observers see fear moving erratically toward panic. Others see the current activity as a necessary, even desirable, correction in an on-going bull market. My stance is a hopeful, not a fearful, vigilance. With the unmerry month of May behind us, we could be heading for the best summer in a couple of years. Stay tuned.