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"7 Reasons the Stock Market Is So Volatile"  
By Adam Shell

NEW YORK — Plunge! Rebound! Crash! Rally! Plunge again! That's been the depressing story line of the stock market the past five trading days, a gut-wrenching, confidence-testing, wealth-destroying bout of volatility that has put investors on edge.

Wall Street has gone haywire again, just as it did in 2008, when stock prices swung sharply up and down like an elevator in a skyscraper during the morning rush. Just as it did on May 6, 2010, when a "flash crash" inspired a short-lived Dow dive of almost 1,000 points. And just as it did on Black Monday in October 1987, when the Dow suffered a record one-day percentage drop of 22.6%.

The signs of the short-circuiting stock market are evident in the unusually sharp price swings recently in the Dow Jones industrial average.

The Dow plunged 520 points Wednesday to 10,720 — its ninth-worst point loss ever. A day earlier, it had soared 430 points, following a super-scary swoon of 635 points on Monday. The mayhem, of course, started last Thursday, when the blue chip index tumbled 513 points.

The causes are many. Traders, investment strategists, money managers and economists all have their theories. "Raw panic," tops the list, says David Kotok, chairman and chief investment officer at Cumberland Advisors.

Computers that make trades in milliseconds based on mathematical models are also being blamed, as are rising fears of a profit-crimping double-dip recession at home and a possible banking crisis in debt-ridden Europe. Forced selling by over-leveraged funds is also on the list.

If your hunch is that this megavolatility is very unusual behavior for the stock market, you are right.

"When you have 500- to 600-point swings in a single day, something is wrong," says Jack Ablin, chief investment officer at Harris Private Bank. "It suggests emotions are playing a big factor in the moves."

Investors might have to get used to it, he adds. " While we may be getting closer to a bottom, a market that is considered fairly valued or cheap can get much cheaper if imaginatons run wild," Ablin warns.

Statistics compiled by market research firm Scanshift.com show just how abnormal — and rare — these outsize moves really are. In the past three days, the Dow has suffered intra-day price movements of more than 5% (those are the only three times that has happened in 2011).

In contrast, last year, there was only one day as wild. And there have been only 45 days with 5%-plus moves in total since 1999. The big outlier for volatility was 2008, when the Dow had 29 daily roller-coaster rides of 5% or more.

"We are not even in the same galaxy as 2008 when it comes to volatility," says Scanshift Chairman Fane Lozman.

### **Damage adds up**

Still, that's no consolation for investors who have seen \$2.2 trillion in stock market value go down the drain in August alone, according to Wilshire Associates.

The damage to the Dow is adding up. It has been down 11 of the past 14 days, leaving it dow 7.4% for the year and 11.7% this month. If there is a silver lining, it is only down 16.3% from its April 29 high, so is still not in a bear market, defined as a drop of 20% or more.

"Volatility," says John Bollinger, president of investment management firm BollingerBands.com, "is basically a function of uncertainty."

And uncertainty, which markets abhor, is a big reason jittery investors are trading the market on every headline, be it bad news or hopeful news, muscling prices up and down wildly in the process.

What's causing the second-to-second, minute-to-minute, hour-to-hour, day-to-day mood swings? A confluence of fears and events, it turns out. Here are seven reasons for the wild ride:

**1. Fear factor.** Fear is driving much of the selling, mainly fear of more substantial losses to come. "It's just one's guy's opinion, but I think the market could retest the lows of March '09, says Todd Harrison, author of *The Other Side of Wall Street*. (The Dow bottomed out at 6547.05 on March 9, 2009; it would have to fall another 38.9% to reach those depths.)

Fear of losses is a self-fulfilling prophecy that makes investors more defensive, which sparks more selling. "People are getting fed up with being whipsawed," says Harrison. "They have financial market fatigue."

Lokanath Patel, 68, a metals engineer from Dubuque, Iowa, says: "I am a little scared, but that's the way the stock market behaves." Still he's hanging tight, although he has 10% of his portfolio in winners such as gold and silver.

Others feel the same. A closely watched Wall Street fear gauge jumped 23% Wednesday.

Individual investors are apparently so fed up that they have now yanked money out of U.S. stock mutual funds for 15 straight weeks, including \$10.4 billion net outflow in the week ending Aug. 3.

**2. Double-dip worries.** There is a tug of war underway on Wall Street between those who think the economy is on the verge of falling back into recession and those who think it won't. Weakening data at home and Europe in crisis is a recipe for a slowdown. And a recession would put a dent in the positive earnings story that's been driving stocks higher for two years.

"The market has changed, and the story has changed," says Woody Dorsey, president of Market Semiotics, a behavioral finance forecasting firm. "The old story was QE2 (bond buying by the Federal Reserve to keep rates low) was producing great earnings, and the market was OK. The new story is QE2 has not solved the global sovereign debt crisis. It was only masking it."

The downside is that a weaker economy will cause earnings to roll over.

**3. Europe uncertainty.** With rumors swirling about the health of the European banking system, and still no bold plan from European policymakers and central bankers to stem the potential contagion from the eurozone's debt woes, investors are unclear on how this crisis will end. European bank stocks and stock indexes got crushed Wednesday.

"Europe is exacerbating the volatility," says Ablin. "The fear is a downturn in Europe could lead to a global recession."

**4. Lack of political leadership.** After the debt-ceiling debacle in Washington and the inability of lawmakers to come up with solutions to the nation's debt problems, investors have lost faith in the ability of leaders to lead.

"The government is totally dysfunctional," says Scott Black, president of money management firm Delphi Management. "There is a lack of leadership. We don't have a plan to get America back on track."

**5. Policy makers out of bullets.** After taking extraordinary steps to try to get the economy back on track, the Federal Reserve and U.S. government have few options left and little ammunition to jump-start the economy. This week, Fed Chairman Ben Bernanke told investors he would leave interest rates at around 0% till mid-2013 to help the moribund economy shake its doldrums. But he offered few other details of how the Fed can stimulate the economy.

"What is playing out is the government lifeguards saved Corporate America in the first financial crisis," says Harrison, who is also founder of Minyanville.com. "Now, financial markets are asking who is going to save the lifeguards."

**6. Computer trades are destabilizing.** With nearly 70% of stock trades now executed by so-called high-frequency traders that use super-smart and super-fast computers, the market's sharp moves are amplified, says George Feiger, CEO of Contango Advisors.

Computer algorithms are too fast, and can jump on trends faster than humans, he says.

"This is analogous to the flash crash," Feiger says. "We have created a market-trading structure which is driven by short-term math decisions that capitalize on quick market movements. Machines don't forecast the future of Europe."

**7. Forced selling.** Many big investors weren't positioned for the rapid downward reversal in stocks. As a result, many hedge funds and other big investors that used borrowed money to boost returns are

now being forced to sell assets to raise money to meet margin calls, says Bollinger. And in today's computer-generated world, these forced sales are done immediately, causing sharp declines in asset prices.

In short, the increased volatility is sending a message that the market is undergoing a change in thinking, says Dorsey. "It's telling us that we have started a new down leg in the bear market. Instead of Lehman Bros., this time it is Greece, Italy, France and U.S. financial assets.

### **Time to go shopping?**

But some money managers say the steep price declines and crazy up-and-down moves offer opportunities to buy stocks cheap. Now's the time to get out your stock shopping list.

Feiger thinks the problems in Europe will force money back into the United States, so he's buying big-cap stocks and resource companies. Black is buying beaten-down stocks, such as CBS and Warren Buffet's Bekshire Hathaway.

"If I can buy good companies at low P-Es, I will," says Black. "I have a three- to five-year time horizon, which makes buying good franchises" a good bet.

Stacy Harris, 58, of Nashville, views the correction as a time to buy. Her focus: stocks of defensive companies that produce stuff people need no matter what, such as makers of toilet tissue, paper towels and food. "Definitely a buying opportunity," she says.

Still, even Black says investors should tread carefully, for now. "It's always better to buy a couple of days after the tsunami rather than get hit by a 25-foot wave," he says.