INVESTORS SHOULD REMEMBER MAY 6TH

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By Rob Rikoon

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May 6th, 2010 was a day that every investor should remember. During a forty minute period that afternoon, the market was in a free fall and many individuals were shut out of their accounts, making trading practically impossible. No price information was available and brokerage firms' phones and faxes were not functioning due to overload.

As a result, price anomalies in many stocks were created when the two largest stock exchanges, the NYSE and NASDAQ, broke down. The breakdown was attributed to a withdrawal of liquid funds by the largest of hedge funds whose role is to make orderly markets in the buying and selling of stocks (market making). Because of their temporary withdrawal from the role of providing liquidity, many pending open trade orders were shunted to small electronic firms whose inner workings are known only to a small group of unscrupulous traders. The results were that those investors without massive computer power were taken hostage by institutions whose business is to take advantage of momentary price differences within imperfect markets, and on May 6th, they had a bonanza.

This is more than a sad and sorry story; it shows how deplorable the stock markets are at their core in protecting the public's interest and puts the future of the stock market in grave doubt. Following the 40 minute black hole period, the NYSE and the NASDAQ made an arbitrary decision to cancel any trade that occurred in that time slot with an error ratio in excess of 60%. This left many small investors who were trying to protect their capital out in the cold.

We now face a critical decision: will vulture institutions be allowed to disrupt markets in the future with their superior information, speed, and large amounts of capital, thereby profiting from actions which are known to be unfair? If so, I strongly urge you to evaluate your portfolio and risk tolerance, because the next time it may be worse.

It was not only individual investors who were harmed by the market makers' failure to do their job, but the companies whose prices were manipulated also felt the effects. Procter & Gamble confirmed that their valid low trade for the day of May 6 was at $56 per share and any other trade level was an aberration due to malfunctioning of the system. Many investors lost their PG stock between $39 and $52 per share. This kind of execution should lead all intelligent investors to question the fairness of the public equity markets. If the stock markets comes to justifiably be seen as a casino with hidden players who have unfair advantages, companies that need to go to the public to raise capital in the future will find a basic source of financing has turned away for good reason, and the competitiveness of our nation will have been dealt a major blow

Congress, the Securities & Exchange Commission and various stock exchanges are now looking to set triggers whereby in the future, trading will stop in individual stocks under certain circumstances so that the travesty of May 6 does not reoccur. Whether or not this will solve the problems or end up causing more is yet to be seen. The public may not be aware of how the technical aspects of what happened on May 6 affected their accounts, but if we complacently let the fox guard the hen house going forward, don't be surprised to wake up one day and find someone stole our nest eggs.

Rob Rikoon is a portfolio manager at The Rikoon Group, a Santa Fe based Registered Investment Advisory firm. He can be reached at rob.rikoon@rikoongroup.com.