

Fear and Greed in the 24-hour Economy

by RICHARD MINSKY

I was sitting in front of my computer last December when an item came on the Business Wire "MBT International Prepares To Launch Online Auction Applications For \$300 Billion Agricultural Industry." I clicked a few buttons and bought 2000 shares at \$4. An hour later it was up to \$8 and I sold it. I should have held on—it went almost to \$14 before it pulled back to close at 8. I called out to Barbara, "Get a bottle of champagne! We just made enough to take a cruise!"

As an economist, though, I couldn't help but wonder: "What's really going on here, and how will this impact the economy?" The first inkling I had that something was happening was just a year ago, when my Russian immigrant auto mechanic, Gary, called me. "Richie," he said excitedly, "Serge is on the cover of *Forbes* Magazine¹, I have a copy for you." I had been keeping my 18-year-old Lincoln running, thanks to Gary's continuous attention, and we had become close friends. I had known his son Serge Milman since he was 10 years old. When Gary complained to me that all Serge wanted to do was play computer games, I told Gary "get him a faster computer." Even though I always believed that those games would build skills for success, I never imagined how Serge would apply them. By the age of 25 he was among the first of the "SOES Bandits" – stock traders who would use the Small Order Execution System to profit from the spread between the buy and sell positions of a stock, buying above the high bid and and selling below the

ask price in a few seconds. The person who clicks the button the fastest gets the trade, which is where the eye-click training of video games becomes critical.

Millions of people are now trading stocks online. Estimates vary, and perhaps 30% of the trades are now done through online discount brokers. What is changing even more significantly is that people sitting at home can now become traders rather than investors. With stock volatility high, particularly on anything with a ".com" on it, many people are inclined to take quick profits rather than hold long positions, despite the higher taxes and all the paperwork. With the rise of ECN's (Electronic Commerce Networks) such as *Island* and *Archipelago*, it's possible to sit at home with a NASDAQ Level II screen and make trades directly with market makers and other traders. The *Level II* stock quote screen gives continuously updating real-time bid and ask prices, along with the backed up bids and asks. You can see a bigger picture of the market, along with the identities of the market makers who are playing.

On an ECN, trades are executed within their system, bypassing the stock exchange. According to a recent New York Times article², trades executed on the ECN's often are done at worse rates than on the trading floor. Part of this may be because the ECN's have not been required to make their quotes public, as are the regulated exchanges. But that will be changing soon (perhaps by the time you read this), because

last December the SEC approved plans for the Alternative Trading Systems to register as either broker-dealers or as independent stock exchanges, requiring them to make their stock quotes public.³

It has only been six months since I opened an online trading account. During this time I have been up as much as 90% over initial capital, and have been subsequently down as low as 45% over initial capital. This is certainly better than leaving it in the bank, but one shouldn't confuse intelligence with a bull market. One of the problems with daytrading on momentum is that you can't blink. One day I went to the refrigerator to get some leftovers for lunch. I came back to the screen three minutes later and a stock had dropped 30% in value. Another time I answered the door, spent five minutes away from the screen, and returned to a 40% loss. Live and learn. One day I pressed a wrong key, and sent in four Sell Limit orders on stocks which I had intended to set Sell Stop Limits. In seconds I had sold all my open positions at prices below what I had paid for them. The trades can take place so fast that there is no time to correct errors. The business of day trading requires concentration, discipline, and experience. One learns this quickly, but mastering the emotions and establishing a peaceful, fast trading station is not an instant process. One moment of distraction can be disastrous.

Is the radical swing in price over a few minutes a market phenomenon or is it manipu-



Photograph courtesy of Herr Stern.

RICHARD MINSKY

Richard Minsky graduated from Brown University (1970 MA Economics), while on a University Fellowship. He also studied with Brown's Master Bookbinder, Daniel Knowlton. In 1970 Richard was awarded the contract as bookbinder to the Joseph H. Hirshhorn Museum and Sculpture Garden of the Smithsonian Institution. In 1971 he was hired as the museum's photographer, and photographed over 2,000 paintings and sculptures.

Minsky was awarded the US/UK Bicentennial Fellowship in 1978, becoming the first book artist to represent America in an international cultural exchange. In 1992 he was the subject of a CNN feature at the time of his 25-year Retrospective Exhibition at HarperCollins. As a teacher he has presented lectures and workshops across the USA, Europe and Africa.

In 1974 Richard Minsky founded the Center for Book Arts, the first not-for-profit corporation dedicated to promoting the art of the contemporary book through exhibitions presented in the context of the public Artists' Workspace, with classes and workshops in all aspects of bookmaking (papermaking, printing, binding, concepts, etc.), and to documenting developments through conferences and publications. Artists and artisans are brought together to enhance each other's instincts and talents. Since 1974, many independent organizations and college programs based on this model have been established across the USA and abroad.

Richard Minsky also designs websites, composes music and plays the violin (blues, jazz, rock & roll, tango, country, other), dances and teaches the Tango, and fences sabre.



Figure 1: Jones Naughton Entertainment (OTC BB: JNNE) One day 5 minute chart, April 6, 1999 (from BigCharts.com). A classic "Pump & Dump." Over 28 million shares traded, with only 9.8 million shares outstanding. The previous day's close was at \$0.14, and the stock went up and down over 100% in a few hours. The pump preceded a bland news release that was issued at 1:05 pm. The Raging Bull chat room had hundreds of posts that day, and by late morning people were guessing that it was insider trading.

lated? The SEC is investigating this issue as I write, but one thing you can do yourself is go to one of the daytrader chat rooms where the leader calls the stock picks and the traders jump in, driving the price up, hoping to get out with a profit before it swings down.^{4,5} Perhaps these unregistered "advisors" are leveling the playing field with the institutional investors, whose research departments provide their traders with plays based on news flashes, earnings reports, technical and fundamental analysis. If you try doing all that yourself while a stock is active, the time it takes to get the information may cost you points on a fast-moving stock. The current SEC investigation deals with insider selling during chat-room instigated price boosts.

The big advance in trading this year has been the development of many stock oriented websites, so people can get huge amounts of research done in minutes. What I've done for myself is make a page with links to my favorite stock analysis tools, so I can quickly find a ticker symbol, fundamentals, short positions, news, chat, charts, etc. You can make your own if you write html, or copy mine.⁶

There is always a stock market open somewhere in the world. Recently the exchanges have been talking about expanding the trading hours. Traders with programs like *RealTick III*, connected directly to services like Reuters' *Instinet*, are trading before and after exchange hours every day. Many brokerages already offer *Instinet* trading service through the live broker, so it is to be expected that the exchanges and brokerages will compete with the demand for longer

trading hours. Soon "daytrading" will be replaced by 24-hour a day trading. As trading hours increase, we can expect the impact velocity of global trading patterns to increase. Stock prices move rapidly on greed and fear,

and tend to crash faster than they rise. In the event of an international fear attack, or perhaps from the effect of daytrader games like *pump & dump* [Figure 1], the response in all markets could be swift and exaggerated.

What happens when the daytraders hit a stock? Take a look at the chart for MBTI [Figure 2].

You can see what happened on December 29. With only 2.5 million shares in circulation, about that many shares changed hands. The stock shot up from an open of \$2 to a high of almost \$14, and back down to \$8, all between the issue of the news release at about 12:30 and the close of trading at 4:00.

It took until the beginning of March for those who got stuck holding the overpriced shares to get shaken out. Note the spike down on April Fool's day (the end of the chart). On the daily chart it creates a classic "hammer" on the candlestick chart,⁷ which is a strong indicator of the end of a down trend. But if you look at the hourly chart (or even better, the 1-minute chart), you will discover there was just one trade of 1,000 shares at 3 5/16. All the other trades at that time were between 3 15/16 and 4 [Figure 3]. Most likely, someone hit a wrong button on their keyboard, and had intended to sell at 3 15/16. MBTI is a "Bulletin Board" (BB) stock, not on a regular exchange, and many rules don't apply (e.g., you can't place "stop loss" limits). On a listed stock, that 3 5/16 trade would not have occurred. After that, traders looking at their quote screen saw that the "low" of the day was 3 5/16, and most wouldn't research beyond that. One can only imagine the impact this had on trading decisions that afternoon. Daytraders often play with

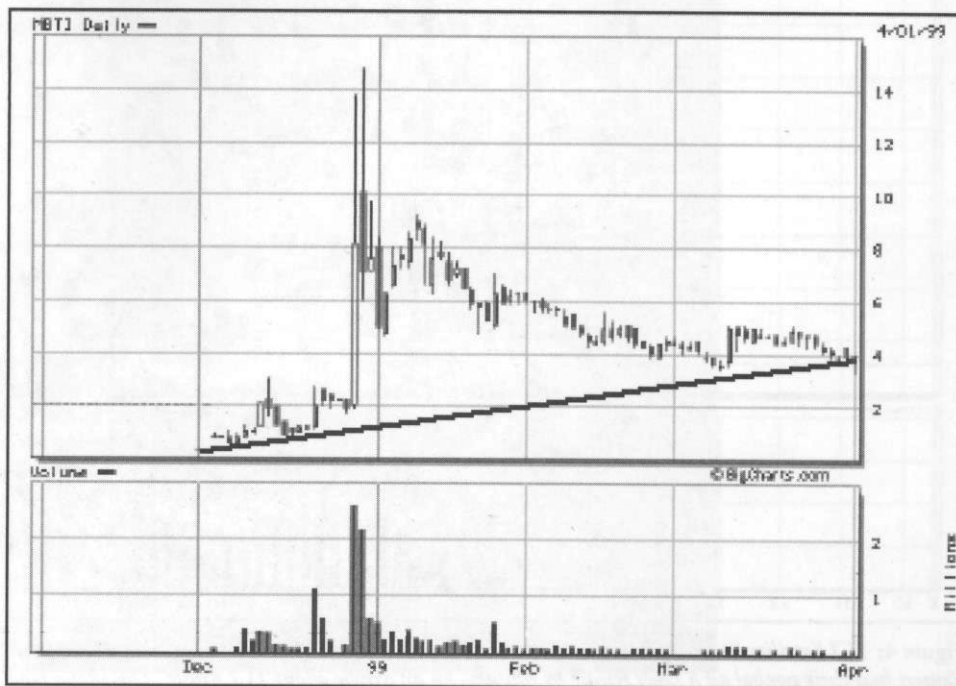


Figure 2: MBT International (OTC BB: MBTI), all data daily candlestick chart (from BigCharts.com), to which I've added a trend line. Note the move to make a "double bottom" at 3_ in the beginning of April, which usually signifies the end of a down trend.

BB stocks, because they are less regulated, more volatile, and often have a smaller float, so fewer shares are needed to influence the market.

Several institutional problems arise when the market becomes this volatile, when dealing with live or online brokerages. Orders cannot be executed as quickly as the price is changing. Limit orders go unexecuted, Market Buy Orders are filled way above the ask price at the time they are placed, and Market Sell orders are executed way below the bid price when placed. This can easily be a 20-50% gap! This makes trading in these stocks very risky [Figure 4]. The problem is, any stock can become the target of daytraders, particularly internet stocks, and today's economy has a high dependence on illusory wealth created by a stock bubble. History has shown what happens in these manias⁸.

When stock prices fall rapidly the online brokerages get backed up and internet connections fail. The brokers can't be reached by phone. On busy days you may not be notified that a Buy Order was executed in time to place a stop loss order before the price drops. During the few seconds a Stop Order takes to be transmitted online, the stock has dropped below the stop price, so the order was not executed. This is not only my personal experience, so now brokerages are putting disclaimers and warnings on their websites.

You've got to choose a strategy and stick to it.^{7,9-13} If your emotions get involved in your decisions its easy to lose money. Pet stocks can tie up your money for months. It's better to take a loss and buy a winner than to wait for the loser to come around. Technical analysis

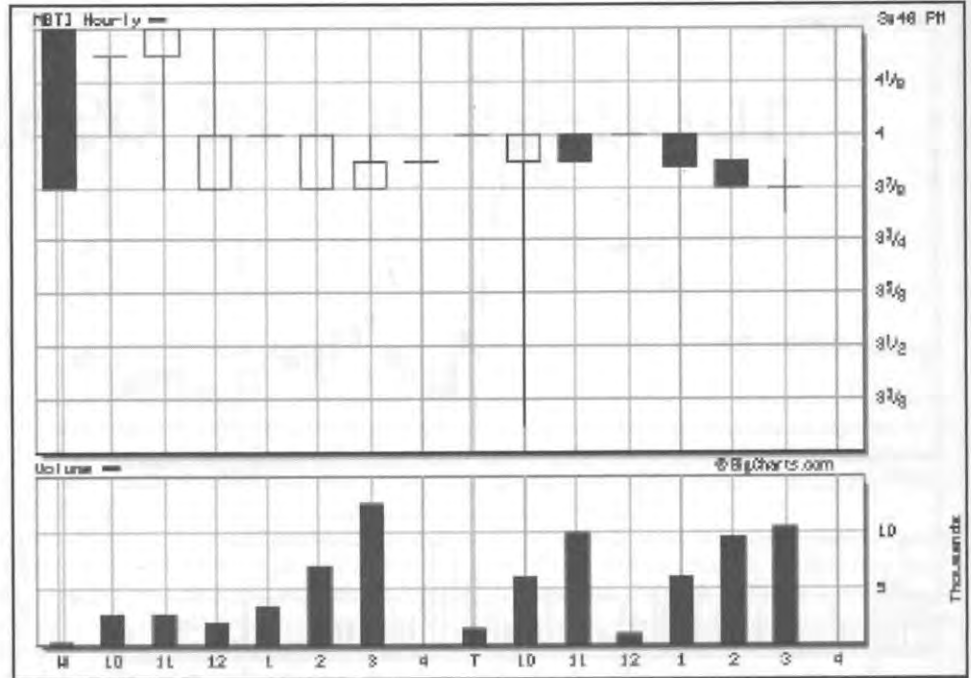


Figure 3: MBTI two day hourly chart, showing a one-trade dip in 10 o'clock hour April 1.

provides some very good tools for choosing buy and sell points.

AFTERWORDS

1. As this goes to press, the President of NASDAQ announced that their exchange will open a second, evening session by late summer. They expect that the session will run from 5 or 6 p.m. through 9 p.m., and

have advised brokerages to staff their trading desks for those hours, so those without electronic trading will be able to participate.

2. Recently a Florida holding company (IAAC) announced the formation of International Trader Association to provide investors with 24-hour online trading of foreign and domestic securities using the Internet. They expect it to be up and running by the third quarter of this year.
3. The December SEC ruling went into effect, and Island announced they will register as an independent stock exchange. I expect the others will soon follow. Meanwhile, online broker E-Trade announced that its clients will be able to use an ECN to trade (they own 25% of Archipelago).
4. The SEC has ruled that stock exchanges can now be operated for profit. The NYSE is planning to open an ECN, perhaps buying an existing one.
5. Volatility is increasing. Look at the daily chart for Verio, Inc. (VRIO) for April. A skilled trader could have made over 200% return in two weeks on the "gap and trap" [Figure 5].

Savings are down, and it seems that borrowing is supplying the cash for the stock bubble. People are buying goods with checks written on their margin accounts. Today's economy depends on perceived wealth. Changes in portfolio value influence spending patterns. The effect of the global electronic trading infrastructure (and its failures) will be profound. Remember the margin calls of 1929.

NOTES

1. "Free Enterprise Comes to Wall Street", by Matthew Schiffrin with Scott McCormack. *Forbes*, April 6, 1998, cover and page 114.

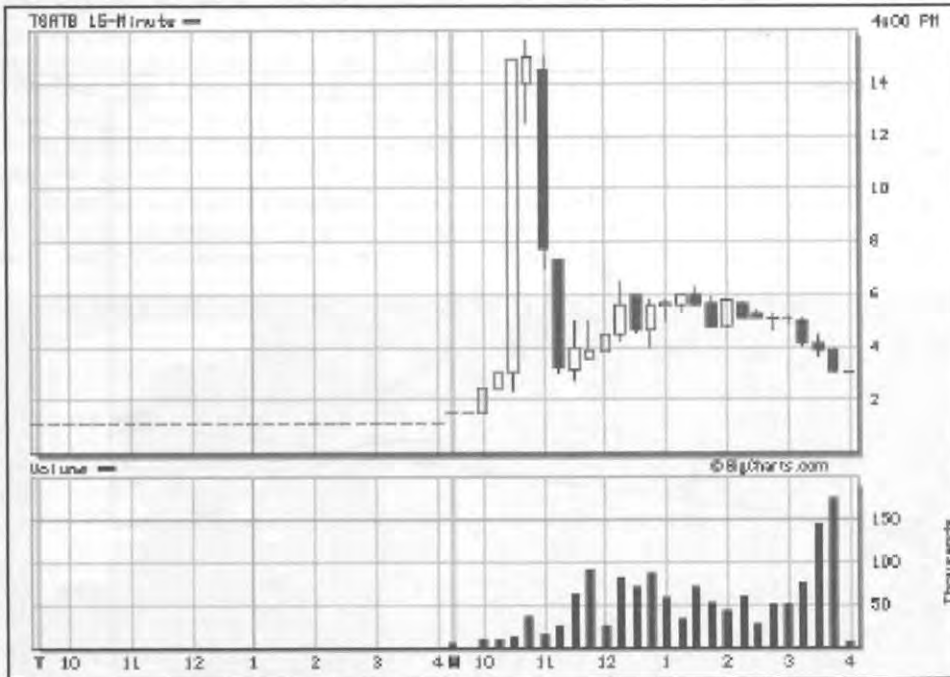


Figure 4: TCI Satellite Entertainment (NASDAQ: TSATB), 2-day 15 minute chart for April 7, 1999. Reuters had their symbol on a news release by mistake, on an article about TCI Music. This shows how many shares can be traded by people who jump on news without doing any research. Over 1.5 million shares traded, on a stock that had almost no activity and traded at about a dollar. It jumped to \$15 in a half hour, until some folks figured it out. Reuters released a correction at 2 pm.

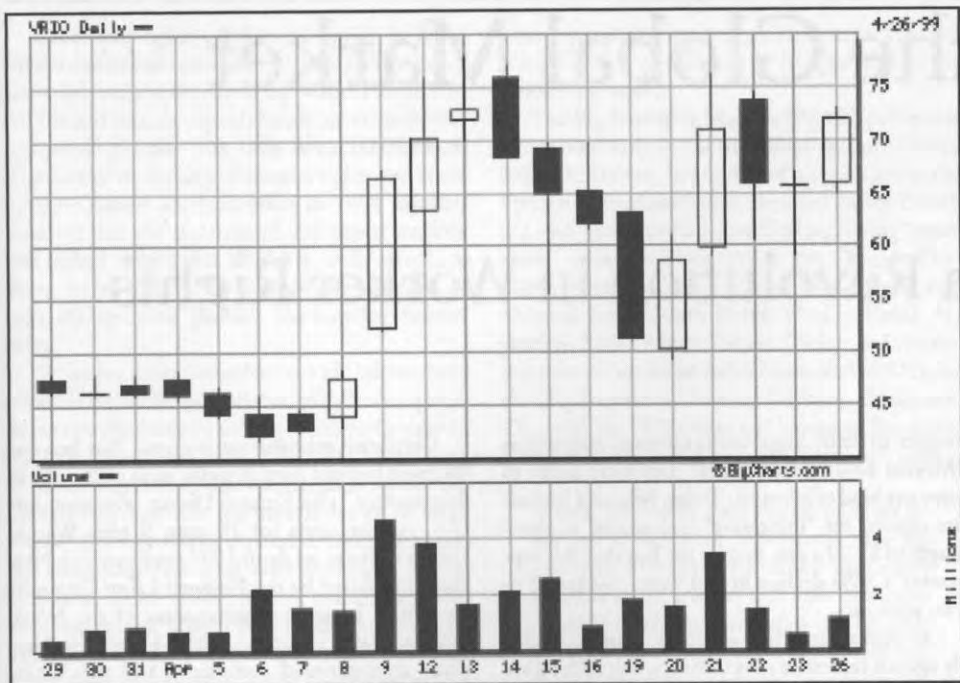


Figure 5: Verio, Inc. (NASDAQ:VRIO) one-month daily chart. Note the gap up on April 12, which is filled on the 20th.

2. Hidden Costs in Online Trading. Gretchen Morgenson. *The New York Times*. Sunday, March 28, 1999. Business Section, Page 1.
3. "SEC OKs Net-Based Stock Markets." R. Scott Raynovich, December 2, 1998. <http://www.wired.com/news/news/business/story/16583.html>
4. Rushing in as Insiders Rush Out. Gretchen Morgenson. *The New York Times*. Sunday, March 28, 1999. Page 1.
5. CNET cooks as chat room touts it, till word comes to 'take profits here'. Susan Pulliam and Rebecca Buckman. *The Wall Street Journal*. March 18, 1999.
6. www.minsky.com/stock (I composed this page with form links to news, chat, and report sites).
7. *Japanese Candlestick Charting Techniques*. Steve Nison. New York Institute of Finance, 1991.8. *Extraordinary Popular Delusions and the Madness of Crowds*. Charles MacKay. (1841) Crown reprint, 1995.
9. *The Psychology of Technical Analysis: Profiting from Crowd Behavior and the Dynamics of Price*. Tony Plummer. Probus Pub Co., 1993.
10. *Martin Pring on Market Momentum*. Martin J. Pring. McGraw-Hill, 1997.
11. *How I made \$2,000,000 in the Stock Market*. Nicolas Darvas. Lyle Stuart, reissue 1986.
12. *The Warren Buffett Way*. Robert G. Hagstrom, Jr. John Wiley & Sons, 1994.
13. "New Company Issues a Debenture That's Secured by a Picture Frame" by Kathleen A. Hughes. *The Wall Street Journal*, March 26, 1984. Page 31.
14. "Art for Debt's Sake" by Richard Sandomir. *Newsday*, March 29, 1984. Page 45.
15. "Ars Gratia Artist" *Money*, June, 1984
16. "Art in Bondage" *Art & Antiques*, June 1984
17. If you haven't been to a daytrading chat room, you might try www.trading-places.net or www.tokyojoe.com.
18. There is a good list of books on daytrading at <http://members.aol.com/vankieptitles.htm>.

Ed. – Richard Minsky's website can be found at www.minsky.com.

