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Weekly Financial Article for the Week of September 10, 2007

The New Volatility

Why is the stock market behaving so wildly these days?

Remember when you would turn on the news and the Dow Jones Industrial Average would be up 30 points or down 20 points for the day? Remember those placid times? You may be wondering where they went. Well, we might not see them for weeks – or even months – as Wall Street tries to maintain equilibrium in one of the more chaotic financial summers in recent history. Here are some reasons why triple-digit ascents and descents are so common these days.

The waves from a perfect storm. Economically, we are still riding them out. Over the last few months, all the elements have come together. Take away access to easy credit. Shrink corporate profits. Then weaken consumer spending. Throw in a spike in foreclosures and oil and gasoline prices. As these developments coincided, investors all over the world decided to sell, or at least reconceive their relationship to risk. In very simple terms, volatility intensifies when additional risks enter the markets. Risk promotes uncertainty – and if nobody anticipates these risks, there is often an emotional reaction to them, even from professional money managers.

Nervousness. Investors are increasingly skittish these days. They can get up-to-the minute economic news from dozens of media outlets – a situation that didn't exist a generation ago. This instant information tends to promote emotional, even hysteric reactions and "mood swings". Witness August 16, when headline after headline brought bad news, as a) Countrywide Financial announced it was borrowing billions of dollars to fund home loans, b) Moody's Investor Service said that the credit crunch might cause a major hedge fund to collapse, c) a report from the Philly Fed showing no growth in factory activity, and d) the news that housing starts had hit a 10-year low. But hours later, bargain hunters ran in and fueled an amazing afternoon rally to erase nearly all of a 340-point dive and leave the Dow down just 15 for the day.

A classic battle between bulls and bears. Some investors see a recession, and some see a rebound. Some hunt for bargains and some sell. Patience really can be a virtue in this market climate, and more patience might mean less volatility.

Quote of the week. "The essential question is not, 'How busy are you?' but 'What are you busy at?' Are you doing what fulfills you?" – Oprah Winfrey

Riddle of the week. There are six words that are both beverages and colors. What are they? (Read the answer here next week.)

Answer to last week's riddle: The man is a priest.