

Program trading used to keep Dow from collapse

WHAT is computer program trading? To explain in the most elementary way, it involves first the actual purchase of stocks in substantial quantity. This drives the price of the stocks purchased upwards. Then profit is taken by selling the stocks at the now higher price and simultaneously selling the index that includes the stocks short. Since selling the stocks and selling the index short now drives the index down in price, profit is taken again as a result of the short sale of the index.

This is naturally an over-simplification. Many computer trading programs are proprietary and kept secret as they would not be as profitable if too many manipulators used the same system.

The White House used a unique manipulation program to force up the Dow Industrial index on October 20, 1987, to restore confidence after the crash, and again on May 12, 1992, the day the Olympia and York bankruptcy was announced. This event was threatening to crash the US stock market which would have been damaging to the Republican president's election hopes. The method used was quite sophisticated. A little-known index called the MMI is traded in Chicago.

This index has only 20 stocks but all are components of the Dow Industrial 30. Naturally, it is easier to manipulate 20 stocks than 30. Since Chicago opens one hour later than New York, the White House manipulators were in place in Chicago one hour after the NYSE opened, where selling had started to drive the market down in New York.

With less than \$60 million buying the MMI long on margin in Chicago, the Dow started rising in New York. At the end of the day, the Dow, which would otherwise have crashed and burned because of the colossal O&Y bankruptcy, was only off 15 points. This prevented a politically devastating crash.

Manipulation of stock markets have long been part of the fabric. This is why astute investors require at least a three per cent dividend yield premium over bond yields to compensate for the frequent manipulation risk.

Manipulation of stock markets is more common today than ever because of the computer which enables even teenage hackers who understand the soft under-belly of computers to become billionaires.

Naturally, small markets are easier to manipulate than the NYSE. Latin American, Asian and other low-capitalised markets are the easiest to manipulate. This is one of the



Money Talks

Leon Richardson

Tips

- We don't buy Chinese B shares because we believe the markets are mal-regulated and corporate accounting practices are primitive. We don't accept this much risk.
- Interest rates have fallen in Australia, the US, and Canada. Low interest rates drive up stocks prices and many assume that is also true of property. It is not. Property values in the US, Canada and Australia are still falling and it is not yet time to buy.
- Don't rely on a US recovery to help Asia because there is no recovery.
- The Tokyo stock market has not yet bottomed out.

Buy Nikkei Puts on any strong rally. Our target is 14,000.

reasons we like the rigid regulation of Singapore as compared to the loose regulations of some Asian markets.

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IT IS *Money Talks'* position that most stock markets are greatly overpriced. One of our most important methods of deciding when stock markets are overpriced or underpriced is the "rule of 20". This measure is not reliable for measuring individual stocks. The reason we don't trust this rule on individual stocks is that earnings of some listed companies may be fabricated by creative accounting in some years. However, when an index is used, the average company's earnings are reasonably correct. (Some companies keep hidden reserves to save tax and use it later to smooth out periods of poor performances. Other inflate earnings for a variety of reasons including directors' bonuses or keeping the stock prices high.) In a group such as an index, they tend to balance out.

We have found the rule of 20 to be incredibly accurate by using a stock market index such as the Dow Jones Industrial Average and the Hang Seng Index. To apply this rule, use the average P/E of the complete index. Add this to the rate of inflation. As example, if the P/E is 17

and the rate of inflation is six per cent, the addition gives 23.

However, the rule of 20 requires that the addition must result in exactly 20. In this case, where the score is 23, the market is overpriced and a wise investor will stay out. At another period, inflation may be four per cent and the average P/E to be 12. Thus the score will be 16. Therefore, buying stocks then is a wise decision as they are likely to move up to the central point of 20.

The rationale for the number 20 as being the dividing line between undervalued and overvalued is that when inflation is low and interest rates low, it is not so difficult for a company to make profit, causing the stock to be profitable.

The profit will force the stock price up and the investor will make money. Conversely, when the interest rate and inflation rate are high, companies tend to make less profit which drives the P/E down by gravitation.

We don't claim the "Rule of 20" infallible but we have tracked it for 20 years with two indices. This rule only failed three times in 20 years, and then only for a short time. Needless to say, in 1987, just before the crash, the Rule of 20 had been volatile on every index we have checked. It was over 30 in the Dow, and 29.7 in the Sydney All Ordinaries.

While we think all stock markets are overpriced this is not to say we think they will quickly fall. We think the Hongkong stock market is greatly overpriced considering both the high inflation and interest rates are higher than those in Singapore, Japan or the US. However, unless there is local social or political unrest, the Hongkong market should stay high until the US stock market falls.

It is not quite ready to fall yet. The driving forces behind the US fantasy stock market is low interest rates, low inflation and the belief the US economy is coming out of recession. We don't think it is coming out of recession, but is merely bouncing because of the adrenalin doses of easy money the Fed has made available.

We think investors will learn by July or August that the recession is not over, and then the market will fall and take the Hongkong market with it.

The best stock to buy now, if you want to buy any, are utility stocks and gold mining shares. Our overall view is that high interest bearing currencies and eurobonds are much more appropriate than today's highly risky stocks.

Pretoria and ANC to share power

FROM GAVIN BELL
IN JOHANNESBURG

SOUTH African political leaders have agreed to try to form an interim, multiracial government before July.

A working group at the Convention for a Democratic South Africa - Codesa - the multiparty negotiating forum, proposed the target date yesterday in an attempt to speed the election of a constitution-making body. The group, which includes representatives of the National party government and the African National Congress, said every attempt should be made to convene the second plenary session of Codesa on April 24 and 25 and to install an interim government by June 30.

Tertius Delpont, the deputy minister of constitutional development, said that if sufficient progress was made in the negotiations, general elections for a new constitution-making legislature could be held next year. The principal parties envisage a two-phase transitional period, involving some form of executive power-sharing, followed by elections.

The government yesterday tabled proposals for a bicameral parliament in the second phase, in which minority parties would have disproportionate representation in the second house. The document rejected the ANC's proposals for a constituent assembly elected on the basis of one man, one vote.

Saki Macozoma, for the ANC, expressed concern that a bicameral parliament would give the leaders of tribal homelands a power of veto in the lower house. However, he agreed there were now similarities between the two parties' concepts of interim arrangements. Gerrit Viljoen, the minister of constitutional development, said political strife in black communities could delay the process.

Musicians' ban on working in S Africa lifted

By Dean Nelson

THE Musicians' Union will lift its ban on performing in South Africa, it was announced yesterday. The decision comes after the pro-reform result of the all-white referendum earlier this month.

The boycott, which began in the mid-1950s, will end next month but the union will continue to discourage "purely commercial tours". Artists should "only accept engagements which have the backing of representative groups of the black population".

Brian Blain, the union's spokesman, said the decision would prompt a rush of artists to Sun City, the entertainment capital for South African whites, but he appealed to musicians to consider the country's black majority. "The least they can do is get involved in mixed audience concerts." The boycott had been the most successful by a British trade union and had prevented many British bands performing to white audiences in South Africa, he said.

Few leading British artists broke the boycott. Queen, the rock group whose singer Freddie Mercury died last year, were the most high-profile band to ignore the ban, but they later apologised to the union and agreed not to tour the country again.

Mr Blain said the recession, and the lifting of the United Nations cultural links boycott last year, had made it impossible to maintain the ban. "The political activists might be unhappy about it but musicians would have thought, 'Sod this, I'm going'. There is a recession and musicians are up

against it." The union would no longer have to veto projects intended for mixed audiences.

Mandla Langa, the African National Congress's cultural attaché, welcomed the move and said he hoped Equity, the actors union, which bans sales of television programmes to South Africa and advises members not to work there, would soon follow. A spokeswoman for Equity said there were no plans to lift the ban, but that there could be a referendum after the union's conference next month.

The Musicians' Union's decision surprised some of the musicians most affected by the boycott - exiled South African musicians in Britain. Several tours were vetoed last year.

Melvyn Afrika, pianist with Zila, the London group, said: "When we were stopped from going we felt a bit discouraged, because many of us were black South Africans. But one of the good things about coming to Britain is that here there is a union to protect you. In South Africa we did not have that. So we understood, but felt a bit frustrated."

Barbara Pukwana, widow of Dudu Pukwana, the band's manager, said: "The tour would have earned the players £200 per show plus all expenses paid. They would have got time off during the week to see their families. So it could have been a good tour, but the artists understood that the situation had to be right."

The Independent

31/3/92

London

The Times

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London.

WORLD BRIEFS

De Klerk's government offers vote

JOHANNESBURG, South Africa — The white-minority government on Monday proposed elections, the first with black participation, for a two-chamber parliament to write a new constitution.

The African National Congress, the largest black political movement, expressed reservations at the plan — which reserves white veto power — but welcomed similarities with its proposals.

Politicians said the multiethnic elections, taking President F.W. de Klerk's government closer to its promise of sharing power with the black majority, could be held by June 30. But no date was set.

Gerrit Viljoen, constitutional affairs minister, said the government was "closing the gap with other parties." The parliament would govern during a transition to full democracy, he said.

■ TODAY'S QUOTE

"Soil that you can't produce crops on anymore is real serious business. This is an alarm bell."

— Robert Livernash, editor of a report by the World Resources Institute that says three billion acres of land, or 11% of the world's vegetated surface area, has become seriously degraded since World War II. The soils are mostly in Asia and Africa. The study drew on data about erosion, salinization and destruction of soil.

— Edited by Wayne Beissert