RealMoney Silver - The Edge

Scott Rothbort, founder and president of LakeView Asset Management, LLC, is filling in for Doug Kass today. Email Rothbort at scott.rothbort@thestreet.com. Doug will return on Tuesday, March 25.

What Does Extreme Volatility Mean?
Scott Rothbort
3/24/08 8:21 AM EDT

Many of the overseas markets are closed for the day after Easter. Thus, we did not get an international reaction to the U.S. markets' activity on Thursday. By extension, we can say that today's action in the U.S. will be solely related to news emanating from our own time zones.

I want to start off the week with some further evidence of the extreme levels of volatility in the markets. I go back to the "up-200, down-200 nonsense," a Jim Cramer quote from several years ago that I utilized as a starting off point on Thursday. Jim was looking at day-to-day market swings. That indeed is true as I have observed from my VDEV calculations.

Now let's take it one step further and look at intraday swings in the market. Calculating the absolute value of the difference in the high and low of the **S&P 500**
divided by the prior day's closing price gives us a good measure of intraday volatility.

From 1962 to 2007, the average ratio of the difference of the daily high and low divided by the prior day's closing level was 1.44%. The standard deviation of those average intraday swings is 0.76%.

For 2008, the average ratio of the difference of the daily high and low divided by the prior day's closing level is 2.21%. That is astonishing from two perspectives. First, the 2008 intraday moves are 53.4% greater in magnitude than the historical average. Second, the 2008 moves represent one standard deviation more than the historical mean.

To give you some recent data for comparative perspective, let's look at the most difficult period in this nine-year bear market in which we are now engaged. From 2000 to 2002, the average ratio of the difference of the daily high and low divided by the prior day's closing level was 1.89%. The 1973 to 1974 period of time, which is in many ways similar to the recent economic and stock market environments, had an average ratio of 2.32%. The next longest bear market (subsequent to 1963), which lasted six years from 1965 to 1970, yielded an average ratio of 1.71%.

When you put this all together, what do you have? We have a market that is exhibiting extreme levels of volatility, even relative to some of the worst periods that we have endured in the equity markets. If history proves right, volatility will abate and the markets will rally. The two years following 1970, the S&P rose 28.1%. The two years following 1974, the S&P rose 56.7%. Finally, the two years after 2002, the S&P rose 37.7%.

Take Action
Scott Rothbort
3/24/08 9:59 AM EDT

My hats off to Jim Cramer for finally using his bully pulpit to hammer the **SEC** on the elimination of the uptick rule. On this site, last July 30, when writing for The Edge, I warned of the dangers of using ETFs for slam dunking and the folly of eliminating the uptick rule. This was presented five months *after* I wrote on these very same Edge pages my 10-point manifesto, "What Must Be Done to Ensure Fair and Orderly Markets, which was also reprinted on my blog.

Sorry to say I told you so, but I told you so. We are now beginning to feel the pain of some of those issues that I brought to light over a year ago. Now that we have Jim and his viewers fully on board, let's follow Jim's lead to help make those necessary changes. So, I ask that all of our readers and "Mad Money" viewers please carefully read what I wrote on these subjects, copy it and enclose it with a letter addressed to anyone who can make a difference in making the markets fair and orderly for the individual investor.

Going Long on BBT
Scott Rothbort
3/24/08 11:16 AM EDT

If chickens could fly, then **Buffalo Wild Wings** (BWLD) would be leading the squadron. I really like this name, as I outlined last week, but I refuse to chase, although it is tempting given that I still have a higher price target.

One stock that I did begin to add last week (and completed my string of purchases early today) is **BB&T** (BBT), a regional bank located in the Mid-Atlantic states.

My position in **Nucor**
(NUE), which I also recently accumulated, is up sharply today after getting bounced around all last week. It remains above my cost basis.

I spent a fortune at Sears over the weekend -- some new home appliances for the LakeView house as well as some power tools -- and **Sears Holdings**
(SHLD) is surging today. While I would like to think that my spending spree may be the proximate cause for the stock life, I think that the raid on Sears has run its course and today's positive existing home sales may be the primary cause for the stock's strength today.

Position: *Long BBT, NUE and SHLD*

Have Our Leaders Forsaken Us?
Scott Rothbort
3/24/08 1:10 PM EDT

Did the old market leaders -- **Apple** (AAPL), **Research in Motion** (RIMM), **Google** (GOOG) and **Intuitive Surgical** (ISRG) -- abandon us? No.

I think they went to Florida for the winter and now are beginning to return home. We all know how bad economic conditions are in Florida right now. My opinion is that these are the stocks that you want to own for multiyear growth purposes.

Unfortunately, I have no position in Intuitive Surgical, while I do in the others. I own all of these at pre-2007 levels. Some at pre-2006 levels.

Please note that I do not consider **Amazon**
(AMZN) to be part of that tech growth foursome because until Amazon is priced like a retailer, it is too overvalued. Given its volatile nature and huge short interest, however, Amazon is likely to be a trader favorite until the world sees it for what it is -- a retailer.

Position: *Long AAPL, RIMM and GOOG*

More on Volatility
Scott Rothbort
3/24/08 2:33 PM EDT

Another indication that volatility has gotten out of control is the magnitude of the day-to-day changes that the market has endured this year. I have prepared the table below, which analyzes the days in which the **S&P 500** has risen or fallen by at least 1%, 2% and 3% for the periods 1950-2007 and for 2008. (Please note for clarification that if the S&P rose by 2.2%, it is counted both in the >1% column and the >2% column.)

Years		**Daily Change in S&P 500**					
		<-3%	<-2%	<-1%	>1%	>2%	>3%
2008	Occurrences	1	8	17	12	4	2
	Percentage	1.82%	14.55%	30.91%	21.82%	7.27%	3.64%
1950-2007	Occurrences	51	237	1,340	1,415	265	64
	Percentage	0.35%	1.62%	9.18%	9.70%	1.82%	0.44%
Ratio of Percentages		5.20	8.96	3.37	2.25	4.00	8.29

As we can see, these large moves, in both directions, are occurring with more frequency in 2008 than in the 58-year period prior to 2008. Here is how you would read the table. In 2008, we had greater than 1% losses in 17 days, or 30.91% of all trading days (55 though last Thursday), vs. 1,340 days, or 9.18% of all trading days (14,592) from 1950 to 2007. Thus, 1% down days were 3.37 times as frequent in 2008 as they were prior to this year. The same can be said for all large down and up days in 2008 vs. the historical averages.

What I find interesting is the rather symmetrical dispersion of the moves in the historical averages. Roughly 9% of the time, we have a down day of more than 1% and an up day of over 1%. Between 1% and 2% of the time, we have up

or down 2% days. Finally, about 0.5% of the time, we have more than 3% up or down moves.

On the other hand, there is less symmetry and more volatile movement in the outcomes for 2008 as nearly 31% of the days were down more than 1% compared to about 22% of the days that were up more than 1%. Two percent moves are also more weighted to the downside, with twice as many down 2% or more days over 2% or greater up days. Up or down days of more than 3% tend to occur with such low frequency that they tend to be statistical outliers.

As we know, markets are mean-reverting. We should expect the conditions in 2008 to reward bullish investors as the volatile nature of the markets begins to calm down to more historic levels as I have outlined over the course of these past two days in The Edge.

On Rumors and Recessions
Scott Rothbort
3/24/08 3:45 PM EDT

I heard from an old friend to the site, who sent me this interesting link. I have to say that between killing the uptick rule and allowing rumors to spread like yelling fire in a movie theater, we have taken the market out of the hands of investors and put it into the hand of manipulators.

Remember, falsely yelling fire in a movie theater is illegal in the U.S. The same should be said for spreading material false rumors (bullish or bearish) in an organized and concerted way. I applaud the U.K. authorities for commencing criminal investigations. One day someone will apply the RICO statutes to some wise guy who conspires with other hedge fund/day-traders to spread false rumors. This is why I don't like to write about rumors that I am hearing, but I will state my own thoughts as pure academic conjecture.

Speaking of old friends to the site, Cody Willard says, hi to all of his old friends. He has some thoughts on the "recession" on his blog. Nearly two years ago, Cody was worried about an economic downturn and recession. I printed a chart from *Bloomberg*
and then Cody and I took a walk around the Seton Hall campus on a nice day for about an hour after the markets closed. I showed him the chart. It was the monthly non-farm payroll chart going back through the last two recessions.

I said that my definition of a recession included (among other things) two consecutive months of non-farm job losses. Unless we have revisions, that variable in my definition is now satisfied. I did go through some other factors in our conversation but concluded by saying that:

- the U.S. economy and the global economies are more diverse than ever;
- central banks are more sophisticated than ever;
- recessions will be shorter-lived and shallower than in the 1980s or earlier; and
- it is likely that we won't know that we had a recession until we already started to pull out of it.

A Strong Day
Scott Rothbort
3/24/08 4:39 PM EDT

We had a very strong day as investors seemed to be warming up to equities once again. Clearly we have put together a nice string of trading days and if you take out the rumor-madness Wednesday session, then one could argue that the downtrend may have been halted.

However, I think that the bears may be willing to give the bulls some more wiggle room before they go back on the offensive. SPX 1400 looks like the next nice round number to stick a stake in the ground. With quarter end on the horizon, we could see some money being put to work in the next few days.

This is not to throw caution to the wind as we still need to be careful in the short run. However, there is much wreckage from which to pick up quality stocks for the long term and smart investors are doing just that while the traders are swinging stocks to and fro.

Have a wonderful evening. I hope you enjoyed my coverage on the Edge and I thank all of you for your emails and kind thoughts. Tomorrow Doctor Kass is back in charge and I will flop back over to the Columnist Conversation.

In addition, I expect to have some new articles in The Street.com University's Finance Professor series this week as I turn my attention to the financial sector. The first is scheduled to be published tomorrow.

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