

# KETRON FINANCIAL, LLC

MARKET WATCH BY GLEN CALKINS

MARCH 30, 2009

In this market rally the market has improved over 20% from its March 9, 2009 low point. U.S. domestic markets were severely oversold. Very likely this rally will last for several weeks. Due to the oversold situation it is widely reported that the first day rally is caused by short covering. **Source: CNBC**  
Short selling has become a significant factor in the market, causing fear and complaints. The history of short selling is long, and the abuses have flared up largely when the market and/or economy were distressed.

"He who sells what isn't his'n, must buy it back or go to pris'n." - Daniel Drew, 1797-1879, American financier  
*"Short sellers are often criticized for exaggerating movements in share prices, distracting management, and profiting from misfortune. Even Napoleon reportedly once called short sellers "enemies of the state." Indeed, short sellers have come in for criticism any time there has been market turbulence."*

1929 - Short sellers among those blamed for Wall Street crash

1932 - U.S. President Herbert Hoover condemns short selling for speculative profit on the New York Stock Exchange

1938 - The U.S. Securities Exchange Commission seeks to restrict short selling by only allowing it when a stock's price is rising, the "uptick rule," which is repealed in 2007

1940 - The Investment Company Act is passed and restricts mutual funds from short selling

1987 - Congress investigates short selling following market crash

2001 - Wall Street firms ask short sellers not to try to profit from falling shares following the September 11 attacks.

2001 - Within two weeks of the September 11 attacks, financial regulators investigate whether groups linked to Osama bin Laden tried to profit by shorting the shares of an insurance company exposed to claims from the destruction

2004 - The SEC approves a new rule called Regulation SHO which seeks to reduce naked shorting by requiring the publication every day of a list of the securities with significant delivery failures. In a naked sale, the seller does not borrow the stock in time to deliver the stock to the buyer within the required three-day settlement period. Reg SHO comes into effect in January 2005

2005 - Overstock.com (OSTK.O) sues research firm Gradient Analytics Inc and hedge fund Rocker Partners, charging that they worked together to spread negative news about the company and drive down its stock price. In a conference call the day after filing the suit, Overstock President and Chief Executive Officer Patrick Byrne claimed the company was in the midst of a conspiracy orchestrated by a "Sith Lord"

2006 - CEO Ken Lay testifies short sellers met in 2001 to conspire to attack Enron (ECSPQ.PK), ultimately bringing it down

2007 - The SEC unanimously repeals the uptick rule in June

2008 - Bear Stearns CEO Alan Schwartz testifies about short sellers inducing a panic and bringing down the firm before the U.S. Senate's finance committee

2008 - The SEC makes an emergency order curbing short selling

**Source: FACTBOX: Milestones in short-selling history**

## Short Selling, Uptick Rule, and Naked Short Selling

### **What Does Short Selling Mean?**

The selling of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller. Short sellers assume that they will be able to buy the stock at a lower amount than the price at which they sold short.

### **What Does Uptick Rule Mean?**

A former rule established by the SEC that requires that every short sale transaction be entered at a price that is higher than the price of the previous trade. This rule was introduced in the Securities Exchange Act of 1934 as Rule 10a-1 and was implemented in 1938. The uptick rule prevents short sellers from adding to the downward momentum when the price of an asset is already experiencing sharp declines.

The SEC eliminated the rule on July 6, 2007, but in March of 2009, following a conversation with SEC Chair Mary

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Schapiro, Rep. Barney Frank of the House Financial Services Committee said that the rule could be restored. Frank's conversations were spurred by a call for the return of the rule by several members of Congress and legislation reintroduced on January 9, 2009, for its reinstatement."

**What Does Naked Shorting Mean?**

The illegal practice of short selling shares that have not been affirmatively determined to exist. Ordinarily, traders must borrow a stock, or determine that it can be borrowed, before they sell it short. But due to various loopholes in the rules and discrepancies between paper and electronic trading systems, naked shorting continues to happen.

While no exact system of measurement exists, most point to the level of trades that fail to deliver from the seller to the buyer within the mandatory three-day stock settlement period as evidence of naked shorting. Naked shorts may represent a major portion of these failed trades."

**Source: Investopedia.com**

The rules have benefited the hedge funds the mutual funds that short, the large brokerage houses that short and the very large investors. These rules have been a deterrent to those who invest based on traditional values, such as retirement funds, mutual funds, and investment advisors. The repeal of the uptick rule, the naked shorting, and the relaxed oversight have served a few well and our nation poorly. From time to time we get an oversold market rally. These have been short lived, often one day but significant in percentage swings. This one day volatility is widely reported to be due to the short sellers buying to cover their risk. What that means to us is in part that the influence of short selling is significant in the market. This means that the rules and regulations of market trading need to be tightened to serve the interests of the nation.

Have we seen the bottom?

Most of us want the answer to be yes. Perhaps we have seen the bottom; it is too early to tell. I would assume that the risk of going lower is sufficiently real to remain cautious. On the good side we have an incredible flow of currency into the economy to get the flow of money reestablished. The old saying is "don't fight the Fed", (Federal Reserve Bank). This means as the Fed moves money in or out of the economy, the economic tide comes in or goes out in ways that will overwhelm the investors who bet against the tide.

Further long term optimism

Bull and Bear Markets								
Bear Market			Followed by Bull Market					
	Beginning	Term Months	% Change	Beginning	Term Months	% Change	Annualized Growth Rate	Months to Recover
1	1929	34	(82)%	1933	167	838 %	17.5%	144
2	1945	6	(22)%	1946	181	903 %	16.5%	35
3	1962	6	(22)%	1962	77	143 %	14.8%	10
4	1968	19	(29)%	1970	30	76 %	25.3%	9
5	1973	21	(43)%	1974	155	838 %	18.9%	21
6	1987	3	(30)%	1987	153	817 %	19.0%	18
7	2000	25	(45)%	2002	61	108 %	15.5%	49
8	2007	17	(55)%					

This table includes information drawn from 2008 Andex Chart and the S&P 500 Index. It is interesting in that it tells us about past and present bull and bear markets. The current market cycle has been worse than any since the depression. We do not know how long or how deep this bear market will be. The other side is what has happened after bear markets. Bull markets of these cycles

have lasted on average about ten years and yielded average growth rates of over 18%.

Not so fast, are we moving into a long term bull market?

First, we do not know, and will not know until it is from looking back and observing the actual bottom. Today the questions include, will we avoid a world depression? Will we have a long cycle of weak economy and high inflation? Inflation meaning we pay higher costs for goods, services, and money. High inflation does not mean a bull market. In the past high inflation stalled market growth, often for years. 1973 to 1982 was a dismal example of the impact of inflation on the stock market. Bonds had good yields, but most of that was eaten up by the inflation.

The Congress disappoints

This seems perpetual, the striving for power and favor rises above the potential to serve for the best of the nation. To me it seems that the elected officials have given little real consideration to the hazards of what they approve. As they sign on with a minimum of thoughtful review, they vote for unprecedented spending without clear plans, financially defined needs or detailed public discussion. Each of the major bailout bills has been quickly passed with regret and questions to follow. Does Congress know how much money (future taxes) they are committing us to? They seem to comply with the old joke: Ready, Fire, Aim.

For the sake of interest, consider the following.

What is a Trillion?		
	<b>1,000</b>	<b>One Thousand</b>
Times 1,000	<b>1,000,000</b>	<b>One Million</b>
Times 1,000	<b>1,000,000,000</b>	<b>One Billion</b>
Times 1,000	<b>1,000,000,000,000</b>	<b>One Trillion</b>
<b>A trillion is one million times one million.</b>		

We have now committed to spend over \$10,000 deferred tax liability dollars for every citizen of the United States in the bailout effort.

Spending several trillion dollars with little discussion, except the effort to attach unchecked political projects (earmarks), is almost incomprehensible.

This money is not all spent right away. Some of it was wrapped into this envelope to change the nature of our nation. The fact that I would like to see us develop economically efficient clean energy or

better education or many other things does not mean that I agree we should commit unprecedented investments into these areas without even a plan of use, just because Congress and the nation have insufficient awareness of the impact of this spending. This is not a criticism of the President, he has a job and understands he can get things approved without meaningful review by reinstating a version of the fear tactic that Bush employed for political rubber stamping of his partially considered agenda. Congress is responsible for the review and control of spending.

### AIG and other bonuses

It is dangerous for Congress to pass laws that are abusive to the rights of a limited number of citizens based upon their contractual income. From what I have read about AIG, (American International Group, Inc.), investigation and indictment for fraud, of some, *perhaps many*, of their people seems appropriate. Termination of many of their personnel seems necessary and appropriate, reclaiming in court ill-gotten gains seems totally reasonable. However, to scapegoat everyone in a group who received a contractual bonus, sounds like politicians circumventing our constitution to pander to the public. In this case it is less than \$1 to be recovered for every \$1,000 the government has committed to the bailout of AIG, or less than \$1 for every \$20,000 that we have committed to the national bailout.

The concern is not whether Congress can find some scapegoat to entertain the public, but rather will they step up to find and correct the real problems.

To do that I recommend that they find out who the market manipulators were that artificially, excessively drove the value of the dollar down, that pumped up the cost of oil to an absurd burden on our economy and the world economy. Who were the manipulators that drove down the values of our real estate assets and banking system? We should change the rules to the benefit of the majority, not those who can pick our pockets without remorse.

If Congress does that they may find some of their presumed best friends have abused that friendship and used their power and investments to undermine our economy, significantly destroy the individual financial standing of those who have retirement funds, personal investments, and/or are home owners, and also jeopardized the international standing of this nation.

### One for the President

In the last few days there has been some debate about suitability for the President being on shows like Jay Leno. In my opinion, our problems are of such consequence that it is vital that we have confidence in the vision and direction of our President. To do that we need several things and one of them is having him in a high level of visibility and not just for those of us who will seek him out. Not all of us get our news or sense of what is happening from the same source. The president should invest his public time where he can find a sufficiently large audience, and hopefully broaden his public contact. I look for the President to find ways to reach a significant percent of the population, giving us confidence that he is working as our president, making decisions that we can feel confident about, aiming at a better future.

At the same time his work should be audited, questioned and reasonably/rationally supported by Congress, not by oversized bills and limited discussion, but by working for the best interest of the nation.

*The information of my newsletters is a combination of my knowledge, specific facts, my analysis and my opinions. The information is intended by me to be useful in understanding some of the complexity of what is happening in the market, economy and governmental impacts. The nature of the document limits how much I offer at any given time and all of this has some time sensitiveness. My opinions do not necessarily align themselves with anyone else in either PIA or Ketrion Financial.*

*Glen*