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Emotional rescue

Stock markets worldwide are filled with all the drama of a daytime soap opera ... sometimes

By P.J. HARSTON

It was personal finance author and speaker David Bach who once said, "This market right now is moving on nothing more than emotions. Guess what? It almost always moves on emotions."

Last week stock and commodity markets around the world turned into soap operas, dripping with drama and starring the world's central banks -- with the U.S. Federal Reserve and its chairman Ben Bernanke leading the charge.

Bernanke is the one who wrote back in 2000, before he had the job, that a good central bank will act to stave off the bad effects of a stock market collapse.

SERIOUS CHALLENGES

"There's no denying that a collapse in stock prices today would pose serious macro-economic challenges for the United States," he wrote in a Foreign Policy article.

"Consumer spending would slow and the U.S. economy would become less of a magnet for foreign investors. Economic growth, which in any case has recently been at unsustainable levels, would decline somewhat. History proves, however, that a smart central bank can protect the economy and the financial sector from the nastier side effects of a stock market collapse."

Friday morning he put his words into action, perhaps saving the U.S. and Canadian markets from suffering a second day of serious losses, which could have spelled disaster -- certainly for the elephant next door that is the American economy.

One day earlier stock markets plummeted, a situation touched off by the subprime mortgage mess in the U.S. and made worse by a credit crunch that began to grip the world earlier in the week. Essentially, nobody was lending any more money because they were afraid they wouldn't ever see it again.

That's when central banks acted. They began lending money, hoping that their willingness to trust others with billions of their dollars would get the cash flowing the way it was just a couple of weeks ago. But it didn't seem to work.

That's why Thursday morning the S&P/TSX composite index -- Canada's main stock market -- and the Dow Jones industrial average -- America's key stock market -- began dropping like stones in a pond, losing hundreds of points as investors sold their stock as fast as they could to get out of markets they no longer had confidence in.

"When emotions are ramping up, they generally ramp up higher than they should," Adrian Mastracci, a portfolio manager at KCM Wealth Management in Vancouver told the Canadian Press.

"The markets fall more than they should and go up higher than they should."

When those emotions boiled over on Thursday, thanks to what is mostly a U.S. problem, they knew no boundaries.

The worry "carried over for no particular fundamental reason into many other areas, some of which should not have been touch at all," Bob Tebbutt, vice-president for risk management at Peregrine Financial Group Canada, told the Canadian Press.

"But it's what happens when madness of crowds gets going."

The diving market was enough to prompt federal Finance Minister Jim Flaherty to try his hand at calming worried investors.

"We must be clear that the fundamentals in our economy are very strong ... and that our financial system remains very capitalized."

However, as Thursday turned into Friday, markets in Europe and Asia continued their downward slide, despite soothing words and open central bank vaults.

That's when Bernanke struck.

INCREASED RISKS

Just before North American markets began trading, just after the Asian markets closed after a second devastating trading day and while Europeans continued to watch their markets slide, the U.S. Federal Reserve approved a half-percentage point cut in its discount rate on loans to banks.

Explaining the action, the bank said that while incoming data suggests the economy is continuing to expand at a moderate pace "the downside risks to growth have increased appreciably."

It also said that "financial market conditions have deteriorated and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward."

When the opening bell rang both in Canada and the U.S., stocks shot up hundreds of points. European markets responded positively and a second day of heavy losses was avoided.

What does it all mean?

Well, it gave the markets a breather after a week of worry and wonder.

And as I wrote earlier in the week, markets matter because if they plunge -- or, God forbid, collapse -- it affects us in the most basic and important of ways: Job losses, inability to access money to purchase a house and it could affect the value of even the safest of investments that millions of Canadians are depending on for their retirements.

Is the drama done?

John Johnston, chief strategist at the Harbour Group at RBC Dominion Securities doesn't think so.

"A lot of the sentiment indicators suggest we've had a massive deterioration, but we're not at the final washout phase. They're saying another low is coming."

And Martin Slaney, head of spread betting at GFT Global Markets wasn't sure.

"The market turbulence has forced the Fed's hand here, and whilst an emergency cut might give the markets some temporary relief, some might say there is a sense of panic coming from the Fed," he said.

Tomorrow is a whole new day and the start of a whole new week of trading.

Which brings me to something investment author Jim Cramer once said: "Every once in a while, the market does something so stupid it takes your breath away."

Indeed.