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My Dog Eats Ice Cream in His Underpants

I remember a game I used to play as a kid called telephone. The game required a group of people. The first guy came up with a phrase and whispered it in the ear of the closest person. This person whispered to the next, and so on until the last person in the line got the message. That person then repeated the phrase that had been passed along. It was at this point that things got funny, because the original phrase usually morphed into something that had little resemblance to the original idea. So go the financial markets.

In September, a 15-year-old boy named Jonathan Lebed, was caught by the Securities and Exchange Commission in a "pump and dump" scheme. Jonathan, a precocious lad, had set up a trading account on his bedroom computer and began buying shares in very small, thinly traded companies. To enhance his chance of success, he posted hundreds of false and misleading messages in various investment related chat rooms, touting the stock he purchased. After the messages took hold and the stock price rose, he would sell at a handsome profit. He reaped gains of more than $270,000 in less than a year. Soon after he left a stock, it would drift back to its original price or lower as the fever wore off. Some of the chat room "victims" were interviewed and said that they thought Jonathan was a 40-year-old professional investor.

In a separate incident, a technology company's stock dropped 50% in one day after a report on the Internet stated that the CEO had resigned in the wake of discovery of significant accounting irregularities at the company. The stock opened the next day with the CEO discrediting the rumors and the stock recovered most of the losses. The SEC is following a trail that leads to a former employee of the company.

The game may have gone high tech, but it doesn't seem to have changed much.

Financial markets are famous for overreaction. The Internet has made the ride wilder. In the past, large, well-known media outlets, filtered by an editorial staff, delivered most of the news we received. The Internet gives anyone with a hook up a voice. Danger waits for those who don't understand the difference between the two. Traditional media is typically strong in fact and source checking, but weak at providing an unbiased viewpoint. The Internet is *the* outlet for instantaneous, unfiltered information, but its sources are suspect. Couple the Internet's shortcomings with an investor's ability to trade stocks instantly, and you have a recipe for rapid and dramatic price swings.

The key, of course, is to avoid being swept up in the emotion surrounding these price swings. Profitability beats rumor every time.

P.S. For those of you keeping score at home - year to date numbers: Dow Jones Industrial Average –7.36, S&P 500 –2.23, NASDAQ Composite –9.74, Lehman Bros. Corp Bond +6.48