Manipulation: How Financial Markets Really Work

By Stephen Lendman
Global Research, May 29, 2009
29 May 2009

Region: USA
Theme: Global Economy

Wall Street's mantra is that markets move randomly and reflect the collective wisdom of investors. The truth is quite opposite. The government's visible hand and insiders control markets and manipulate them up or down for profit – all of them, including stocks, bonds, commodities and currencies.

It's financial fraud or what former high-level Wall Street insider and former Assistant HUD Secretary Catherine Austin Fitts calls "pump and dump," defined as "artificially inflating the price of a stock or other security through promotion, in order to sell at the inflated price," then profit more on the downside by short-selling. "This practice is illegal under securities law, yet it is particularly common," and in today's volatile markets likely ongoing daily.

Why? Because the profits are enormous, in good and bad times, and when carried to extremes like now, Fitts calls it "pump(ing) and dump(ing) of the entire American economy," duping the public, fleecing trillions from them, and it's more than just "a process designed to wipe out the middle class. This is genocide (by other means) – a much more subtle and lethal version than ever before perpetrated by the scoundrels of our history texts."

Fitts explains that much more than market manipulation goes on. She describes a "financial coup d'etat, including fraudulent housing (and other bubbles), pump and dump schemes, naked short selling, precious metals price suppression, and active intervention in the markets by the government and central bank" along with insiders. It's a government-business partnership for enormous profits through "legislation, contracts, regulation (or lack of it), financing, (and) subsidies." More still overall by rigging the game for the powerful, while at the same time harming the public so cleverly that few understand what's happening.

Market Rigging Mechanisms – The Plunge Protection Team

On March 18, 1989, Ronald Reagan's Executive Order 12631 created the Working Group on Financial Markets (WGFM) commonly known as the Plunge Protection Team (PPT). It consisted of the following officials or their designees:

— the President;

— the Treasury Secretary as chairman;

— the Fed chairman;

— the SEC chairman; and

— the Commodity Futures Trading Commission chairman.

Under Sec. 2, its “Purposes and Functions” were stated as follows:

> (2) “Recognizing the goals of enhancing the integrity, efficiency, orderliness, and competitiveness of our Nation’s financial markets and maintaining investor confidence, the Working Group shall identify and consider:
>
> (1) the major issues raised by the numerous studies on the events (pertaining to the) October 19, 1987 (market crash and consider) recommendations that have the potential to achieve the goals noted above; and
>
> (2)....governmental (and other) actions under existing laws and regulations....that are appropriate to carry out these recommendations.”

In August 2005, Canada-based Sprott Asset Management (SAM) principals John Embry and Andrew Hepburn headlined their report on the US government’s “surreptitious” market interventions: “Move Over, Adam Smith – The Visible Hand of Uncle Sam” to prevent “destabilizing stock market declines. Comprising key government agencies, stock exchanges and large Wall Street firms,” this group “is significant because the government has never admitted to private-sector membership in the Working Group,” nor is it hinting that manipulation works both ways – to stop or create panic.

“Current mythology holds that (equity) prices rise and fall on the basis of market forces alone. Such sentiments appear to be seriously mistaken....And as official rhetoric continues to toe the free market line, manipulation has become increasingly apparent....with the active participation of selected investment banks and brokerage houses” – the Wall Street giants.

In 2004, Texas Hedge Report principals Steven McIntyre and Todd Stein said “Almost every floor trader on the NYSE, NYMEX, CBOT and CME will admit to having seen the PPT in action in one form or another over the years” – violating the traditional notion that markets move randomly and reflect popular sentiment.

Worse still, according to SAM principals Embry and Hepburn, “the government’s unwillingness to disclose its activities has rendered it very difficult to have a debate on the merits of such a policy,” if there are any.

Further, “virtually no one ever mentions government intervention publicly....Our primary concern is that what apparently started as a stopgap measure may have morphed into a serious moral hazard situation.”

Worst of all, if government and Wall Street collude to pump and dump markets, individuals and small investment firms can get trampled, and that’s exactly what happened in late 2008 and early 2009, with much more to come as the greatest economic crisis since the Great Depression plays out over many more months.

That said, the PPT might more aptly be called the PPDT – The Plunge Protection/Destruction Team, depending on which way it moves markets at any time. Investors beware.

Manipulating markets is commonplace and as old as investing. Only the tools are more sophisticated and amounts involved greater. In her book, “Morgan: American Financier,” Jean Strouse explained his role in the Panic of 1907, the result of stock market and real estate speculation that caused a market crash, bank runs, and hysteria. To restore confidence, JP Morgan and the Treasury Secretary organized a group of financiers to transfer funds to troubled banks and buy stocks. At the time, rumors were rampant that they orchestrated the panic for speculative profits and their main goals:

— the 1908 National Monetary Commission to stabilize financial markets as a precursor to the Federal Reserve; and

— the 1910 Jekyll Island meeting where powerful financial figures met in secret for nine days and created the private banking cartel Federal Reserve System, later congressionally established on December 23, 1913 and signed into law by Woodrow Wilson.

Morgan died early that year but profited hugely from the 1907 Panic. It let him expand his steel empire by buying the Tennessee Coal and Iron Company for about $45 million, an asset thought to be worth around $700 million. Today, similar schemes are more than ever common in the wake of the global economic crisis creating opportunities to buy assets cheap by bankers flush with bailout cash. Aided by PPT market rigging, it's simpler than ever.

Wharton Professor Itay Goldstein and Said Business School and Lincoln College, Oxford University Professor Alexander Guembel discussed price manipulation in their paper titled "Manipulation and the Allocational Role of Prices." They showed how traders effect prices on the downside through "bear raids," and concluded:

"We basically describe a theory of how bear raid manipulation works….What we show here is that by selling (a stock or more effectively short-selling it), you have a real effect on the firm. The connection with real value is the new thing….This is the crucial element," but they claim the process only works on the downside, not driving shares up.

In fact, high-volume program trading, analyst recommendations, positive or negative media reports, and other devices do it both ways.

Also key is that a company's stock price and true worth can be highly divergent. In other words, healthy or sick firms may be way-over or under-valued depending on market and economic conditions and how manipulative traders wish to price them, short or longer term.

The idea that equity prices reflect true value or that markets move randomly (up or down) is rubbish. They never have and more than ever don't now.

The Exchange Stabilization Fund (ESF)

The 1934 Gold Reserve Act created the US Treasury's ESF. Section 7 of the 1944 Bretton Woods Agreements made its operations permanent. As originally established, the Treasury ran the Fund outside of congressional oversight "to keep sharp swings in the dollar's exchange rate from (disrupting) financial markets" through manipulation. Its operations now include stabilizing foreign currencies, extending credit lines to foreign governments, and last September to guaranteeing money market funds against losses for up to $50 billion.

In 1995, the Clinton administration used the fund to provide Mexico a $20 billion credit line to stabilize the peso at a time of economic crisis, and earlier administrations extended loans or credit lines to China, Brazil, Ecuador, Iceland and Liberia. The Treasury's web site also states that:

"By law, the Secretary has considerable discretion in the use of ESF resources. The legal basis of the ESF is the Gold Reserve Act of 1934. As amended in the late 1970s....the Secretary (per) approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities."

In other words, ESF is a slush fund for whatever purposes the Treasury wishes, including ones it may not wish to disclose, such as manipulating markets, directing funds to the IMF and providing them with strings to borrowers as the Treasury's site explains:

> "....Treasury has often linked the availability of ESF financing to a borrower's use of the credit facilities of the IMF, both to support the IMF's role and to strengthen assurances that there will be timely repayment of ESF financing."

The Counterparty Risk Management Policy Group (CRMPG)

Established in 1999 in the wake of the Long Term Capital Management (LTCM) crisis, it manipulates markets to benefit giant Wall Street firms and high-level insiders. According to one account, it was to curb future crises by:

— letting giant financial institutions collude through large-scale program trading to move markets up or down as they wish;

— bailing out its members in financial trouble; and

— manipulating markets short or longer-term with government approval at the expense of small investors none the wiser and often getting trampled.

In August 2008, CRMPG III issued a report titled "Containing Systemic Risk: The Road to Reform." It was deceptive on its face in stating that CRMPG "was designed to focus its primary attention on the steps that must be taken by the private sector to reduce the frequency and/or severity of future financial shocks while recognizing that such future shocks are inevitable, in part because it is literally impossible to anticipate the specific timing and triggers of such events."

In fact, the "private sector" creates "financial shocks" to open markets, remove competition, and consolidate for greater power by buying damaged assets cheap. Financial history has numerous examples of preying on the weak, crushing competition, socializing risks, privatizing profits, redistributing wealth upward to a financial oligarchy, creating "tollbooth economies" in debt bondage according to Michael Hudson, and overall getting a "free lunch" at the public's expense.

CRMPG explains financial excesses and crises this way:

> "At the end of the day, (their) root cause....on both the upside and the downside of the cycle is collective human behavior: unbridled optimism on the upside and fear on the downside, all in a setting in which it is literally impossible to anticipate when optimism gives rise to fear or fear gives rise to optimism...."
>
> "What is needed, therefore, is a form of private initiative that will complement official oversight in encouraging industry-wide practices that will help mitigate systemic risk. The recommendations of the Report have been framed with that

objective in mind."

In other words, let foxes guard the henhouse to keep inventing new ways to extract gains (a "free lunch") in increasingly larger amounts – "in the interest of helping to contain systemic risk factors and promote greater stability."

Or as Orwell might have said: instability is stability, creating systemic risk is containing it, sloping playing fields are level ones, extracting the greatest profit is sharing it, and what benefits the few helps everyone.

Michel Chossudovsky explains that: "triggering market collapse(s) can be a very profitable undertaking. (Evidence suggests) that the Security and Exchange Commission (SEC) regulators have created an environment which supports speculative transactions (through) futures, options, index funds, derivative securities (and short-selling), etc. (that) make money when the stock market crumbles….foreknowledge and inside information (create golden profit opportunities for) powerful speculators" able to move markets up or down with the public none the wiser.

As a result, concentrated wealth and "financial power resulting from market manipulation is unprecedented" with small investors' savings, IRAs, pensions, 401ks, and futures being decimated from it.

Deconstructing So-Called "Green Shoots"

Daily the corporate media trumpet them to lull the unwary into believing the global economic crisis is ebbing and recovery is on the way. Not according to longtime market analyst Bob Chapman who calls green shoots "Poison Ivy" and economist Nouriel Roubini saying they're "yellow weeds" at a time there's lots more pain ahead.

For many months and in a recent commentary he refers to "the worst financial crisis, economic crisis and recession since the Great Depression….the consensus is now becoming optimistic again and says that we are going to go from minus 6 percent growth to positive growth in the second half of the year….my views are much more bearish….The problems of the financial system are severe. Many banks are still insolvent."

We're "piling public debt on top of private debt to socialize the losses; and at some point the back of (the) government('s) balance sheet is going to break, and if that happens, it's going to be a disaster." Short of that, he, Chapman, and others see the risks going forward as daunting. As for the recent stock market rise, they both call it a "sucker's rally" that will reverse as the US economy keeps contracting and the financial system suffers unexpected or manipulated shocks.

Highly respected market analyst Louise Yamada agrees. As Randall Forsyth reported in the May 25 issue of Barron's Up and Down Wall Street column:

"It is almost uncanny the degree to which 2002-08 has tracked 1932-38, 'Yamada writes in her latest note to clients.' " Her "Alternate Hypothesis" compares this structural bear market to 1929-42:

— "the dot-com collapse parallels the Great Crash and its aftermath," followed by the 2003-07 recovery, similar to 1933-37;

— then the late 2008 – early March 2009 collapse tracks a similar 1937-38 trajectory, after which a strong rally followed much like today;

— then in November 1938, the market dropped 22% followed by a 26% rise and a series of further ups and downs – down 28%, up 23%, down 16%, up 13%, and a final 29% decline ending in 1942;

— from the 1938 high ("analogous to where we are now," she says), stock prices fell 41% to a final bottom.

Are we at one today as market touts claim? No according to Yamada – top-ranked among her peers in 2001, 2002, 2003 and 2004 when she worked at Citigroup's Smith Barney division. Since 2005, she's headed her own independent research company.

She says structural bear markets typically last 13 – 16 years so this one has a long way to go before "complet(ing) the repair process." She calls the current rebound "a bungee jump," very typical of bear markets. Numerous ones occurred during the Great Depression, 8 alone from 1929 – 1932, some deceptively strong.

Expect market manipulators today to produce similar price action going forward – to enrich themselves while trampling on the unwary, well-advised to protect their dollars from becoming quarters or dimes.

Stephen Lendman is a Research Associate of the Centre for Research on Globalization. He lives in Chicago and can be reached at lendmanstephen@sbcglobal.net.

Also visit his blog site at sjlendman.blogspot.com and listen to The Global Research News Hour on RepublicBroadcasting.org Monday – Friday at 10AM US Central time for cutting-edge discussions with distinguished guests on world and national issues. All programs are archived for easy listening.

Articles by: Stephen Lendman

About the author:

Stephen Lendman lives in Chicago. He can be reached at lendmanstephen@sbcglobal.net. His new book as editor and contributor is titled "Flashpoint in Ukraine: US Drive for Hegemony Risks WW III." http://www.claritypress.com/LendmanIII.html Visit his blog site at sjlendman.blogspot.com. Listen to cutting-edge discussions with distinguished guests on the

Progressive Radio News Hour on the Progressive Radio Network. It airs three times weekly: live on Sundays at 1PM Central time plus two prerecorded archived programs.