

# Market Plunge: Separating Math from Mania

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By Kathy Kristof | May 6, 2010

Worries about the spreading Greek debt crisis coupled with reports of weak retail sales sent U.S. stock prices plunging Thursday, with the Dow Jones industrial average shedding nearly 1,000 points before recovering some ground by the end of the trading day.

But even after the late-day rally, the Dow took a 347.8-point hit, closing at 10,520.32 and the S&P 500 lost 37.72, closing at 1,128.15. That's got these key barometers of U.S. stock market health shedding a whopping 6.5% and 7.8% of their value in less than a month.

Is this a sign of a double-dip recession and a signal that investors ought to get out while they can? No. Market experts said Thursday that it was a classic market panic driven by investor psychology and computerized trading that tends to exaggerate market moves.

"The stock market is a barometer of investor nerves," said Gary Schlossberg, senior economist with Wells Capital Management. "You cannot make the case for this magnitude of decline from the market's fundamentals."

Indeed, securities regulators said late Thursday that they were investigating the "unusual trading activity" that caused the Dow to plunge some 700 points in a matter of minutes. Some reports claimed a number of "erroneous trades" caused the share prices of Blue Chip companies to crater, climbing back only minutes later.

Does that mean it was just a glitch and it's over? Not necessarily. Investors, made skittish by last year's market meltdown, are likely to remain nervous and ready to run at the slightest sign of weakness. The dirty little secret of Wall Street is that stock prices aren't always rational. They're driven by two things: Math and Mania.

Mania appears to be ruling the day at the moment. The reason behind it: people are concerned about the debt crisis in Greece and whether that's likely to spread to other European countries. But the impact of that debt crisis on U.S. companies is subtle and speculative at the moment, said Schlossberg.

In the meantime, U.S. market math looks fairly positive.

One of the key mathematic indicators of a stock's value is the price/earnings ratio. In short, it's the current market price of a company's stock divided by the company's annualized earnings per share. If you look at this ratio and apply it to the S&P 500, market prices have gone from "fair to attractive," said David Brady, chief executive of Brady Investment

Counsel.

While different experts measure market p/e's in different ways — Brady takes a look at median “normalized earnings” while Schlossberg compares market prices to an amalgam of projected earnings — both came to the same conclusion. Stock prices were at reasonable values before this sell-off started. Now prices are pretty attractive.

That said, May is traditionally a “sloppy” month, said Brady. In fact, the [Stock Trader's Almanac](#) suggests that stocks typically sell off in May and stay lackluster until October.

What does this mean for you? If you have a reasonable investment strategy, ignore the day-to-day movements and stay the course. Just because the market is maniacal doesn't mean you have to be.

<http://moneywatch.bnet.com/saving-money/blog/devil-details/market-plunge-separating-math-from-mania/2047/>

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Kathy Kristof is a syndicated personal finance columnist, speaker and author of three books, including the recently updated *Investing 101* (Bloomberg, 2008).

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