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You Call This a Crisis?

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The impact of not being able to trade stocks on Nasdaq pales against lots of other things.

Oh, the moaning and gnashing of teeth!

One would assume it was over an event on the scale of the deaths of more than 100,000 in Syria, some from attacks with chemical weapons, or the bloody clashes in Egypt. "What is happening now in the Middle East is the most important event so far of the 21st century, even compared to the financial crisis we have been through and its impact on world affairs," William Hague, the U.K. foreign secretary, said last week (although one might rank 9/11 even higher).

No, the great human tragedy being played out on the financial cable channels was the outage at the Nasdaq Thursday afternoon.

Imagine not being able to trade shares of the likes of Apple (ticker: AAPL), Amazon.com (AMZN) or Google (GOOG) for more than three whole hours! It created an existential crisis. Do these companies actually exist if investors cannot trade claims on their future values? And if you own one of those claims, are they worth anything if you cannot obtain an instantaneous quote? This was a huge failing for the country, threatening our very national security.

I confess to having been blissfully unaware of the Nasdaq outage at the time, as I was stuck in a doctor's office that afternoon, dangerously cut off from the markets and the rest of the world while my smartphone was wrested from my hands as I underwent some tests. My impression was that the rest of the office also was ignorant of what was happening in electronic equity markets as the staff and doctors went about their business of treating patients. Only later would I learn of the tragedy that had befallen us.

Can this great nation long endure a lack of stock trading? Perhaps on a somnolent late-summer day, and then for a few hours. But for weeks or months? Well, it has happened, and during a period of great crisis. And the nation not only survived, but arguably benefited.

With the outbreak of World War I at the end of July 1914, Treasury Secretary William G. McAdoo ordered the New York Stock Exchange closed in order to prevent massive liquidation of U.S. stocks by British investors seeking to raise cash. (At the time, the Treasury Secretary was the de facto central banker; although legislation to create the Federal Reserve had been passed the previous year, it was not yet up and running.)

The U.S. then was operating under the gold standard, so the proceeds of sales of American assets could be readily converted to gold, which could flee the country. (This account comes from *When Washington Shut Down Wall Street*, a 2006 book by William L. Silber, an economics professor at New York University and—full disclosure—a professor of mine in grad school.)

A crisis was averted and, later that year, the NYSE was allowed to reopen. By avoiding a suspension of the gold standard, Silber writes, the U.S. became the international financial center, eventually supplanting Great Britain in that role.

Investors in Microsoft (MSFT) who might have otherwise sold Thursday should thank the Nasdaq for thwarting that possibility. In the great tradition of Charlie Bluhdorn, Microsoft shares jumped nearly 8% Friday after Chief Executive Steve Ballmer announced his intention to retire within 12 months.

Bluhdorn was the consummate *conglomateur* of the 1970s, combining prosaic companies with the glamorous likes of Paramount Pictures into Gulf+Western Industries, memorably satirized in Mel Brooks's *Silent Movie* as "Engulf and Devour." In one of the great tales of business history, when news of Bluhdorn's succumbing to a heart attack aboard his private jet in 1983 got out, Gulf+Western shares soared.

So, there are worse things than not being able to trade stocks. Still, it is widely agreed that incidents such as the shuttering of the Nasdaq require a vigorous government response. No doubt SEC Chairwoman Mary Jo White will summon the heads of the exchanges to knock those same heads together to prevent future such glitches.

Here is a case where government might do a better job than the private sector. Who is better at monitoring information networks—which is what exchanges essentially are—than the government? My modest proposal is to put the Nasdaq, the NYSE, et al., under the watchful eye of the NSA. After all, everything else already is.

AS THE U.S. TREASURY Secretary did nearly a century ago, finance ministers and central bankers in emerging-market countries are grappling with the problems of falling capital inflows, or even outflows, at the same time they face current-account deficits or dwindling surpluses. And that includes some of the formerly rock-solid BRICs.

That's meant plummeting currencies and stock markets for two of that august quartet, India and Brazil. Russia is being sustained by elevated oil prices, while official data from China (for what they're worth) say its economy is stabilizing, although there's reason for skepticism that anything has changed substantively since our colleague Jon Laing penned his perceptive cover story two months ago ("Where Will It End?" June 24).

While a century ago the gold standard prevailed (at least until the outbreak of World War I), the world basically now is on a Fed standard. The U.S. central bank's policies in great part determine global liquidity, because the dollar remains the world's main currency for trade, finance, and as a store of value. So, what Ben Bernanke and whoever succeeds him does or says is felt far beyond America's borders.

Anticipation of the receding tide of Fed liquidity—with the widely discussed reduction in the bank's $85 billion-a-month purchases of Treasury and agency mortgage-backed securities—has put great stress on the currencies of countries with current-account deficits. By the ineluctable math of the balance of payments, a current-account deficit must be offset by a capital-account surplus; in other words, money coming in from abroad. The issue always is the cost of that foreign capital, and that has been rising sharply, mainly in terms of a deteriorating exchange rate for the emerging-market currencies.

Since the beginning of May, when Bernanke started to talk about tapering, the Brazilian real and the Indian rupee are down 15%, while the Australian dollar and the South African rand show double-digit declines. In some cases, notably that of the Aussie dollar, the drop corrects an overvaluation. That currency has come down to about 90 cents from a peak around $1.10.

These currency declines have magnified the losses for U.S. dollar investors, who can readily plunge into these once-inaccessible markets via exchange-traded funds. The WisdomTree India Earnings ETF (EPI), the iShares MSCI Brazil Capped (EWZ), the iShares MSCI Indonesia (EIDO) and the iShares MSCI Philippines (EPHE) all are in bona fide bear markets, having slid 30% from their respective highs.

India, in particular, has had a rough time in recent days, first hiking interest rates to defend the rupee and then trying to cap bond yields to bolster its slowing economy. This demonstrates the inherent contradiction in trying to juggle the exchange rate (which requires tight money) and to underpin the real economy (which usually means monetary easing.)

Some of these emerging economies, notably Brazil, have accused the Fed of starting a "currency war," beginning with the second stage of quantitative easing, QE2, in late 2010. By effectively printing dollars through the purchase of securities, Brazil argues, the U.S. was engaging in a competitive devaluation to boost exports and the American economy—to the detriment of other countries.

That trend's reversal is roiling these economies, as the tide of easy money that rolled in now is going out. Not that the Fed shows concern. Bernanke has contended that the emerging markets could offset these capital flows with their own interest-rate policies. For relatively smaller, open economies, that's easier said than done.

The surge in U.S. bond yields also is having an impact on the domestic economy. New-home sales plunged 13.4% in July, to a 394,000 seasonally adjusted annual rate, from a sharply downwardly revised pace of 455,000, which originally was estimated at 497,000. These are the first data that fully reflect the percentage-point jump in 30-year fixed-rate mortgage rates. Unlike previously occupied homes—which have been scooped up by institutional investors and opportunistic individuals using cash—new homes typically are bought by folks looking to move in, and using mortgages. Higher mortgage rates raise the monthly nut, which reduces the price buyers can pay for a new house. The median home price edged down last month, to $257,200 from $258,500.

While some economists resorted to blaming the weather—the equivalent of saying the dog ate my homework—home builders' stocks anticipated this sorry showing. The iShares US Home Construction ETF (ITB) is in bear territory with a 20% drop from its high. And applications to refinance have fallen off the cliff, resulting in Wells Fargo (WFC) announcing plans for 2,300 layoffs.

So, will the Fed taper its bond purchases in September with housing activity slowing sharply, more bad news from retailers about consumer spending, and global markets cracking? And ahead of another possible debt-ceiling debacle and possible government shutdown on Oct.1?

It wouldn't be the first policy blunder.

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