A Matter of Opinion

Actions by regulators and exchanges show some promise for individual investors in the areas of buy/sell spreads for small-cap stocks and frivolous lawsuits.

Stock Returns and Regulatory Relief: All in All, Not a Bad Year

By James B. Cloonan

As of this writing (mid-December), it looks like an extremely rewarding year for investors, but of course any real analysis must await the final results. I will discuss the various market segments, as well as our Beginner's Portfolio, after the final figures are in at the end of the year. [The Beginner's Portfolio was started three years ago to examine the problems and procedures of managing a portfolio of small stocks using a consistent approach that could be followed without heavy time commitments.]

It has also been a very active year for regulatory organizations and exchanges, including Nasdaq. Individual investors use the Nasdaq exchange frequently because it includes most of the small-capitalization stocks, and also hits some of the most exciting of the large-cap stocks—for instance, Microsoft, Intel, etc.

Spreads for Small Stocks

Spreads—the difference between the price you would pay to buy a stock and the price you would receive if you sold the stock—on Nasdaq, particularly on the small- and medium-capitalization companies, have appeared to be quite wide. This has been a concern in managing the Beginner's Portfolio and we had to eliminate stocks from consideration if their spreads were too wide.

For instance, three small capitalization stocks that I am currently examining have an average bid/ask spread of 8%. It is very difficult to invest successfully and pay spreads this wide. This is particularly true if turnover equals or exceeds 100% a year, implying that stocks on average are held for one year or more.

The SEC and the NASD feel that the wide spreads are due to the system and have both introduced plans to reduce spreads, particularly for individual investors. The Justice Department thinks there may also be collusion and is carrying out an investigation.

One Certainty Is Change

While no one is certain exactly what changes will be made, the one thing we can be sure of is that changes will be taking place during the first quarter of 1996, and they will reduce spreads because investors will often be able to cross orders with each other rather than having to go through market markers and paying their spreads. In addition, the various execution systems will all have to show the best bids and offers.

The final details have yet to be worked out, but the above features are sure to be included. It will reduce the frustration of individuals seeing trades executed beyond the range of the bid or ask prices they entered.

I have been in that position for several days myself. I have been trying to sell my position in CHRZ (Computer Horizons) for $35 per share. Over the last several days it has traded at $35, $35¼, and $35½, but I have not sold any shares—somewhere, an individual is paying $35½ when he could have purchased my shares for $35.

Under the systems being suggested, this won't happen. I look forward to the quick implementation of the proposals.

Frivolous Suits

The other change of note is the regulation to limit the current ability to bring securities fraud lawsuits. The bill that the president is about to sign is a compromise, and while others might do it differently, it does seem to be a balance between protecting true investor rights and reducing frivolous lawsuits.

Of course, I am always in favor of maximum investor rights. The problem with this area, though, is that both sides include investor rights. In many of these suits, shareholders end up suing themselves because corporations indemnify their officers. Thus, ultimately it is shareholders who are paying the damages, as well as the extremely high cost of the attorneys' fees for both sides. If the new law turns out to be unfair in either direction, it can be adjusted later.

Happy new year to all, and many happy returns.

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