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'Flash crash' may be sparking stock fund withdrawals

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By Adam Shell, USA TODAY

NEW YORK — Retail investors have yanked money out of stock mutual funds for 17 straight weeks. And the still unexplained May 6 "flash crash" — when the Dow Jones industrials plunged more than 600 points in minutes before recovering — is increasingly being cited as a key reason the public has been selling.

In a speech Tuesday, Mary Schapiro, chairman of the Securities and Exchange Commission, said the SEC was informed by retail brokers that the Main Street investors they cater to "have pulled back" from the stock market since the flash crash.

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To buttress her point, Schapiro noted that stock funds have suffered net outflows every week since the flash crash. In contrast, in all 11 weeks leading up to the mayhem of May 6, net inflows were positive, with retail investors pouring roughly \$26.6 billion into stock funds, Ned Davis Research says.

While there are many other factors to explain why investors have been fleeing stocks since the flash crash — the European debt crisis, nearly double-digit unemployment and recent fears that the economy may slip back into recession — many experts cite the flash crash as the selling catalyst.

"I don't want to argue that all the selling is due to the 'flash crash,'" Ned Davis noted in a recent client report. "I just think that was the trigger."

Since the start of 2008, investors have been fleeing stock funds in favor of bond funds, which are viewed as safer. Still, there's no question that seeing the Dow fall so far so fast with so little warning took a big bite out of confidence, says Michael Farr of investment firm Farr Miller & Washington. "It made the individual investor more certain in their suspicion that the (stock investing game) is fixed," he says. The fact that regulators have yet to explain why it happened and whether it can happen again, he adds, is an overhang on the market. Still, Farr says it has faded from his clients' minds: "I haven't heard a peep about the flash crash in months."

Bob Cohen at Financial Strategies & Wealth Management says the flash crash is just one cause for the recent flight from stocks. He stresses that double-dip fears, lack of jobs, political infighting in Washington and risks from unstable places abroad are bigger factors in the rising aversion to risk. The flash crash "is a new risk factor," he says. "But it should not prevent you from investing."

Schapiro, the SEC chief, acknowledges that it is worrying if the flash crash is why investors are selling: "The trend is troubling, particularly if concerns about equity market structure are playing even a small role in investor decision-making."

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