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Issues Within the US Stock Market and Possible Solutions

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Abstract: The US stock market is one of the largest and most influential financial markets in the world. Throughout the course of history, it has played an important role in US societal development. And as the world enters the digital age, the US stock market is adapting to the latest technological developments, which could generate some potential problems. This paper examines the issues within the US stock market and their possible solutions, reaching the conclusion that market fluctuations, insider trading, market manipulation, and lack of investor education are examples of major problems within the US stock market. After describing each problem, this paper proposes potential solutions to deal with the problem, including transaction taxes, stricter enforcement, enhancing penalties, and so on. Overall, the research presented in this paper could be viewed within the larger context of academic conversation regarding the US stock market. The results and conclusions could inform the general public of the current state of the US stock market and provide suggestions to governmental officials and policy makers.

Keywords: US stock market, FinTech, Ethics, Governmental and social policy.

1. Introduction

The stock market plays a crucial role in the economy by providing businesses with opportunities for expansion, increasing government revenue, and helping individual investors to accumulate wealth. The stock market is one of the important sources of funding for companies. Companies use the stock market to gather investment by issuing stocks to the public. The acquired capital is important for business expansion and progress in research and development. Also, the stock market can help to increase government revenue through taxation, such as transaction taxes. These revenues would provide funding for public services and infrastructure. In addition, the stock market helps individual investors to accumulate wealth. Individuals can strategically invest in various companies and earn interest through appreciation and dividends.

The US stock market is particularly important among all the stock markets across the world because of its size, influence, and central role in the global economy. The US stock market is the largest and most influential financial market across the world. Through trading in the New York Stock Exchange (NYSE) and NASDAQ, it sets standards and influences trends within the global financial market. The US stock market is also able to attract a large amount of international capital, as investors from across the world trade US stocks because of the size, stability, and performance of the market. The ties with global capital serve to elevate the central position of the US stock market to the global economy.

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While large and influential, the US stock market faces some problems, such as market fluctuations, insider trading, market manipulation, and lack of investor education. This paper delves deeper into these problems and proposes possible solutions to each problem.

2. Problems

2.1. Market Fluctuations

Market fluctuations refer to the constant changes in stock prices, which can be driven by various factors. Market fluctuations in the US stock market is a major challenge for investors, financial institutions, and policymakers. Such trends could be attributed to a number of factors, such as high-frequency trading and geo-political events.

With technological advancements, the stock market is becoming increasingly digitalized. And many new terminals and platforms for financial information and transactions emerged. This trend increases the frequency of trade, as trade could be easily made on these platforms without geographical and time constraints. Nowadays there is an asset trade occurring every few seconds. The high frequency of trading destabilizes the market because the increase in the sample of transactions increases the possibility of a larger variance. For example, Aït-Sahalia, Yacine, and Yu mention that the sum of square log-returns has traditionally been used as an estimator to measure an asset's volatility because of its desirable properties. However, with an increase in the trade frequency, this estimator exhibits asymptotic properties, making it less able to predict market volatility [1]. This shows that high frequency trade increases the variance and fluctuations within the stock market.

Geo-political factors could also serve to influence stock prices and therefore cause market fluctuations. Events like political uncertainty, trade wars, sanctions, or international conflicts can cause significant price changes in the US stock market. For example, the trade war between the US and China trade led to significant market fluctuations from 2018 to 2019, as tariffs and trade restrictions affected the profitability of many US companies.

2.2. Insider Trading

Within the US context, insider trading refers to the buying or selling of a publicly traded company's stock by individuals who possess non-public data or information about the company. This illegal practice can lead to market distortions, unfair advantages, and legal penalties for those involved. Insider trading is a significant problem in the US stock market, undermining the fundamental principles of fairness, transparency, and investor confidence that are crucial to the functioning of financial markets. For example, Abdolmohammadi, Mohammad, and Sultan mention that "Various types of information, including real or perceived insider information that can be traced to a variety of sources, often permeate the trading" [2]. This quote shows that the usage of insider information undermines the fairness of the market and raises ethical concerns for investors. The article also mentions a study in which the sample perform competitive stock-trading under the condition of knowledge of insider information. The competitive nature of the trading simulation gives the subjects financial incentives to use the insider information in trade, as the opportunity of economic gain outweighs ethical concerns, which is in a lot of ways similar to the real-life scenario.

2.3. Market Manipulation

Market manipulation undermines the fairness of competition and distorts the price formation process, which is essential for efficient markets. It occurs when individuals or groups deliberately influence stock prices or market conditions to benefit their own financial interests at the expense of the general public. Market manipulation can take many forms, all of which are illegal under US securities laws

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and can cause considerable harm to the financial system, investor confidence, and the overall economy. For example, Spatt and Chester mentions that "Manipulation can arise in a range of manners, such as across related markets (e.g., stock versus option markets or the announcement of a takeover bid), across time (exploiting natural differences market depth or liquidity over time), or across institutional contexts, such as through the preopening in virtual markets, as well as open, close, and within-the-day trading" [3]. This quote shows that market manipulation distorts the market in various dimensions and depends on the context to a large extent.

2.4. Lack of Investor Education and Financial Literacy

Financial literacy refers to the ability to understand financial concepts and effectively use financial skills, including investing, budgeting, and debt management. This skillset is relatively lacked among the US population, especially those who did not receive higher education. A lack of financial literacy can lead to poor investment decisions, lower participation in economic opportunities, and increased vulnerability to fraud. This is particularly important in the US context because the stock market plays a crucial role in personal finance, retirement savings, and economic stability in US society. According to a study which examines financial literacy among the young using the most recent wave of the 1997 National Longitudinal Survey of Youth, financial literacy is low is relatively low among the youth, as fewer than one-third of young adults possess basic knowledge of interest rates, inflation, and risk management [4]. This would increasingly become a problem as investors nowadays are faced with financial decisions at a younger age than previous generations, as well as the fact that the surveyed generation are finding employment and becoming participants of the stock market.

3. Possible Solutions

3.1. Transaction Taxes and Regulation of HFT

The problem of fluctuations in the stock market could be dealt with transaction taxes and regulation of high frequency trade. Implementing a certain amount of tax on each financial transaction could reduce speculative trading by increasing the cost and therefore the risk of investment, serving to discourage the large number of short-term trades. Imposing transaction taxes could raise the tax revenue from the financial sector, which is a desirable outcome for the economy. It could also deter some of the undesirable transactions which harm the general social well-being. However, the level of taxation should not be too high to also prevent the desirable transactions. For example, Darvas, Zsolt, and Weizsacker mentions that "However, such a financial transaction tax should be very small, much smaller than the negative externalities in question, because it is a blunt instrument that also drives out socially useful transactions" [5]. This quote shows that the scope of application for transaction taxes is large. Therefore, the tax rate should be appropriately defined because of the potential side effect of also preventing desirable transactions.

High-frequency trading (HFT) uses algorithms to execute thousands of trades within milliseconds. It can increase market fluctuations, especially during periods of significant price changes. While HFT provides liquidity, it could lead to market crashes and excessive short-term price changes. Therefore, the government could tighten regulations on HFT to ensure that it contributes to market stability. Measures could include limiting the speed at which transactions could be made. Upgrading surveillance systems could also help reduce the market impact of HFT.

3.2. Stricter Enforcement and Whistleblower Protections

Insider trading could be addressed by stricter enforcement, whistleblower protections, and increased data disclosure. Stricter enforcement could be established in the form of stronger regulatory agencies.

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In the US, The Securities and Exchange Commission (SEC) is the primary agency responsible for enforcing insider trading laws. However, the large volume of trades and the complexity of cases can overwhelm enforcement efforts. As a result, the government should increase the SEC's resources, including staffing and technology to detect insider trading more efficiently. Enhanced surveillance tools like advanced algorithms, artificial intelligence, and big data analytics can help the agency to identify suspicious activities.

Whistleblowers can be crucial in exposing insider trading activities, especially when they involve senior management positions. Potential protection schemes should be established to encourage more potential whistleblowers to expose offenses. The SEC's whistleblower program could be strengthened by offering economic incentives and providing greater legal protection to reporters of insider trading. Under the Dodd-Frank Act, whistleblowers can receive between 10% and 30% of the fines collected if the information they provide leads to enforcement action resulting in fines exceeding $1 million. Increasing the reward percentage and expanding the scope of protections would encourage the increase in the number of whistleblowers.

3.3. Enhancing Penalties, Improving Surveillance, and Establishing Social Media Oversight

The problems of market manipulation could be confronted by enhancing penalties, creating more effective surveillance utilizing software engineering and artificial intelligence, as well as establishing stricter oversight of social media.

Existing penalties for market manipulation may not be severe enough to deter individuals or institutions from engaging in market manipulation. As a result, the government should increase both economic and civil penalties for those offenders. For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act increased some penalties, but further punishments could serve to deter potential manipulators. In addition, firms involved in such schemes could face broader consequences, such as loss of trading licenses, bans on market participation, and degradation of credibility.

Also, many forms of market manipulation could be difficult to detect with traditional tools.

Therefore, more investments should be made in advanced technologies such as artificial intelligence and machine learning to detect manipulative activities more efficiently. These technologies can analyze large amounts of data more efficiently than humans and help to identify suspicious activity. Exchanges like the NYSE and Nasdaq should also use similar tools to enhance their internal monitoring systems.

In addition, recent market events highlighted how online platforms, and social media could for market manipulation. Coordinated efforts by large groups of investors can drive up prices artificially. Therefore, stricter regulations should be implemented regarding the use of social media and online platforms for stock trading discussions. This could include requiring platforms to monitor and flag suspicious manipulative activities, while also enforcing increased transparency and disclosure requirements. Agencies like the SEC could also create guidelines for monitoring and reporting market manipulation from social media.

3.4. Implementing Investor Education Programs, Reforming School Curriculum, and Requiring Occasional Tests

The lack of investor education and financial literacy could be resolved by implementing investor education programs, increasing financial literacy education in schools, as well as requiring occasional tests in financial companies. Investor education programs could be launched to raise financial awareness of the public and provide educational resources for people to study financial concepts such as stock investing and risk management.

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Financial literacy should also be more integrated into the school curriculum. A major reason for the lack of financial literacy is the absence of comprehensive financial education in schools. Many Americans enter adulthood without understandings of basic financial concepts. As a result, reforms should be made to mandate financial literacy courses in high school curriculums across the US, with a focus on personal finance, investment basics, and financial planning. This could include lessons on understanding stock market volatility and evaluation of risks The courses should be practical, engaging, and applicable to real-life scenarios, ensuring that students learn how these concepts affect their personal financial lives. However, it must be noted that enrollment in finance courses does not equate to increased financial literacy sometimes. For example, Martinez and Valeria mentions that "exposure to a wide variety of business courses is a good substitute for personal financial literacy. Nonetheless, previous work in this field has proven this belief wrong" [6]. This quote shows that taking courses is not a substitute for financial literacy. The curriculum and education should be designed to enable students to retain and apply the acquired knowledge and skills.

In addition, finance companies could occasionally require employees to take tests on important financial subjects such as investment basics and risk management. This would help to evaluate the employees' competence and ensure that they are qualified to perform the required tasks [7-10].

4. Conclusion

Overall, an analysis and interpretation of the US stock market seems to suggest that it is crucial for the global financial market because of its size and influence. Also, while large and influential, the market could face some problems, such as market fluctuations, insider trading, market manipulation, and lack of investor education, which undermine the efficiency of the US stock market. Solutions have been proposed to deal with each problem, such as transaction taxes, stricter enforcement, enhancing penalties, and so on.

This paper explores some major problems faced by the US stock market and their possible solutions. Future research could focus on the structural systematic cause of such problems, or the relation of such problems with the latest technological developments. These investigations would help to provide a comprehensive understanding of the US stock market.

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