

Rate hike fears give Wall St. the jitters

Sell-off drops Dow below 10,000 mark

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The prospect of an interest-rate hike sent investors into a selling frenzy yesterday, sending the U.S. financial markets tumbling to their lowest levels in months. The most dramatic barometer of investor sentiment was the bellwether Dow Jones industrial average, which slipped below 10,000 for the first time since December.

The bleak day for investors came on the heels of some of the best economic news in two years. During the first quarter, corporate America swam in profits, and last week, the latest jobs report showed payrolls were exploding.

But there is a downside, too. Investors fear too much economic growth will ignite inflation and prompt the Federal Reserve to ratchet up interest rates, which have remained at a 46-year low of 1 percent for 11 months. Economists expect Fed Chairman Alan Greenspan to push for a rate increase as early as next month.

"The Fed is indicating more and more that they're going to raise interest rates," said Gus Faucher, a senior economist at economy.com in West Chester, Pa. "As the Fed makes it more and more apparent, it's all sort of sinking in."

Higher interest rates are likely to slow the growth of corporate profits because they make it more expensive to borrow money. At the same time, companies can suffer if higher rates force consumers to spend less. Those prospects could make alternative investments look more attractive, Faucher said.

"Part of it may be an overreaction, but the markets are forward-looking," he said. "It's not just about what has happened. It's about what will happen. Investors are looking at profitability down the road."

The uncertainty over interest rates has been building for several months, but some experts said the jitters were aggravated yesterday by an assortment of geo-political events: rising oil prices, the intensifying scandal over U.S. Army abuse of prisoners in Iraq and the tightening of money in China.

"These are all factors that cause people to sell first and ask questions later," said John Longo, senior vice president of investment strategy at The MDE Group, a financial services firm in Parsippany.

The financial markets have been drifting down for the past month after climbing steadily for the previous 14 months. Yesterday, the major market gauges tumbled to their lowest levels so far this year.

The Dow ended down 127.32 points, or 1.26 percent, to 9,990.02. It was the first time the Dow closed below the 10,000 mark since Dec. 10, 2003.

The broader Standard & Poor's 500 index fell 11.59 points, or 1.05 percent, to 1,087.11, its lowest level in nearly five months. The Nasdaq composite index, which is dominated by technology companies, dropped 21.89 points, or 1.14 percent, to 1,896.07, its lowest close since November.

As the markets slipped yesterday, volume hit 877 million shares on the New York Stock Exchange and 916 million on the Nasdaq.

Trading was heavy with 1.92 billion shares changing hands on the New York Stock Exchange -- above the 1.4 billion daily average for last year. About 1.89 billion shares were traded on the Nasdaq, higher than last year's 1.8 billion daily average.

In the U.S. Treasuries market, the benchmark 10-year note declined in price, boosting its yield to 4.79 percent, the highest since mid-2002. Since mid-March, yields have risen about 110 basis points, hoisting mortgage rates sharply higher in the process.

While the looming impact of higher rates has provoked the neurotic nature of the equity markets lately, another fear has centered on skyrocketing gas prices, leading to a potential drop in consumer spending.

That may be less likely now that the Saudi Arabian oil minister has called on the OPEC cartel of oil-producing nations to raise supply targets. More oil on the market would lower prices.

"For the most part, this is fear rather than deteriorating fundamentals," said John Lonski, chief economist at Moody's Investor Services, about the decline in the stock market.

"This is not like 2001. This is not 2002 either. The fact that we have improved the financial condition of corporate America suggests the equity market is not going into a slump," he said.

Lonski said the U.S. economy could shoulder an increase in the federal funds rate of 2 percent to 3 percent. Faucher agreed. "In terms of the economy, where I sit, things look strong," Faucher said.

But the prospect of higher interest rates prompts investors to readjust stock prices to reflect the effect of an interest rate hike. Professional investors are asking what constitutes a proper price-earnings ratio, Lonski said.

Still, most experts considered yesterday's slide an overreaction.

"It's paradoxical," said Longo, from The MDE Group in Parsippany. "The market worries much more about inflation and interest rates than it should."