

Dow's free fall has economists' attention

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Stock markets behaved in a way calculated to ruin any investor's vacation Thursday, with major indexes falling at a dizzying rate until about an hour before the end of trading, when they began a supercharged rebound to close almost where they began.

By noon, the Dow Jones industrial average had reached an intraday low just under 12,518, more than 10% below its all-time high of 14,000, set just last month. That drop of more than 10% from high to low is the classic definition of a market correction, something that has not happened for four years.

However, by the end of the day, the Dow had rebounded to close at 12,845.78, just 15.69 points below where it started.

The more broadly based Standard & Poor's 500 index had a similar pattern, closing up 4.57 points at 1411.27 after falling as far as 1370 during the day.

The initial weakness was more indicative of the state of the economy than the ending charge was, experts said. Lingering worry about problems in the credit markets has spooked investors, and many economic indicators say things may slow by the end of the year. If that happens, corporate profits and cash flow will suffer, taking stock prices with them.

There is a 30% chance of a recession by the end of the year, said Bruce Bittles, chief economist for Milwaukee's Robert W. Baird & Co., "and it wouldn't take much to raise it to 50% or more," he added.

The underlying reason is that Americans are used to buying on credit and are dependent on growth in the value of assets such as their houses and retirement accounts to do so, he said. As the growth in asset values either slows or stalls, as it has done recently thanks in part to problems in the credit market, so does consumer spending. That in turn slows the entire economy, something the market fears, he said.

"The markets have so much downside momentum that until you break that momentum, all rallies are suspect," said Bittles.

Much of the market's behavior Thursday was the result of mass psychology, said Brian Jacobsen, economics professor at Wisconsin Lutheran College, Wauwatosa, and chief economist at Capital Markets Consultants in Milwaukee.

Once investors began to sell at the start of the day, many others decided it was a good thing, too, he said.

The fall came even after it was announced that the Federal Reserve had pumped \$17 billion into the banking system in recent days to help ease the credit crunch.

The market would like the Fed to actually cut interest rates, Bittles said.

Because of the underlying state of the economy, the size of Thursday's initial fall was to be expected, even with the Fed action, Jacobsen said.

"A correction wasn't so much a matter of if it was going to happen but when and how quickly," he said. "Markets are supposed to be forward-looking, and some of our indications are that economic growth is not increasing as rapidly as it has in the past. . . . You couldn't really justify some of the major increases we have seen in those broad market indexes."

Given where the market is today, however, some buying might be appropriate, said Kenneth J. Brusda, president of North Star Asset Management Inc., Menasha. He is more optimistic about the economy's future than either Bittles or Jacobsen.

"If you are a leveraged hedge fund or a buyer of these subprime mortgage pools, it is pretty much a disaster," Brusda said. However, for the average long-term investor, the market is providing a 9% or 10% discount, he said.

As Thursday's trading ended, computerized programs used by some hedge funds and other professional traders kicked in, helping the late rally, said C. Mark Heaselden, director of equity research for Associated Investment Management in Milwaukee.

But bargain hunters also helped, said Jacobsen. The run-up was "just noise driven; it was not driven by news," he said.

"You just had a lot of people sitting on the sidelines, almost like vultures," waiting for a low enough price, Jacobsen said. "It is kind of like bidding on eBay. You don't have a lot of activity until the auction is ready to close."