The Wall Street Report **Equity valuation**

US stocks suffer worst falls in eight months

Trump says 'Fed has gone crazy' after rate rises help send Nasdaq down more than 4%

Enthusiasm faded near the end of the Thursday session on Wall Street © AP

Nicole Bullock, Joe Rennison and Peter Wells in New York OCTOBER 10, 2018

US stocks suffered their worst fall in more than eight months on Wednesday as recent interest rate rises undercut popular trading strategies and sent shares of once high-flying technology stocks tumbling.

The tech-heavy Nasdaq Composite dropped more than 4 per cent, its biggest one-day decline since June 2016, while the S&P 500 fell 3.3 per cent, its worst day since February. The benchmark index has fallen five days in a row — its longest losing streak of Donald Trump's presidency.

The US sell-off bled into Asia in early morning trading on Thursday. Shares in companies listed in China and Hong Kong dropped by more than 3 per cent, while Japan's Topix index was down as much as 3.4 per cent. Technology companies were among the worst hit.

Mr Trump quickly responded to the US market sell-off by renewing his criticism of the US central bank's commitment to raising interest rates, saying: "The Fed is making a mistake. They're so tight. I think Fed has gone crazy."

Mr Trump, who has broken with the policy of his recent predecessors not to comment on the Fed and interest rate policy, added: "It's a correction that we've been waiting for, for a long time. But I really disagree with what the Fed is doing, OK?"

Analysts and traders characterised the market turbulence as a delayed reaction to the sharp move higher in US interest rates that began last week. Recent simultaneous falls in stocks and bond prices — which move in the opposite direction of yields — helped disrupt algorithmic trades that are common on Wall Street, they said.

"There has been some damage done to these strategies and it will take some time to rebalance them," said Peter Tchir, chief macro strategist at Academy Securities.

> **The Fed is making a mistake. They're so tight. I think Fed has gone crazy**
>
> **President Donald Trump**

As the stock market decline gathered force on Wednesday, Treasury yields eventually reversed course, sliding into the close of trading on Wall Street and finishing the day down 4 basis points at 3.16 per cent.

"At first equities were catching up to the move higher in yields in the past week . . . as the capitulation continued, a flight to quality and liquidity occurred driving yields lower," said Jonathan Hill, an interest rate strategist at BMO Capital Markets.

Investors said the move echoed the S&P 500's correction in February, which was also blamed on expectations of higher rates. Wall Street's so-called "fear gauge," the Cboe's Vix volatility index, rose above 20 for the first time since April — but remained well short of the readings above 50 during the market turbulence earlier this year.

Analysts said this month's spike in US Treasury yields has called into question the high valuations put on tech stocks during the bull market that began in 2009.

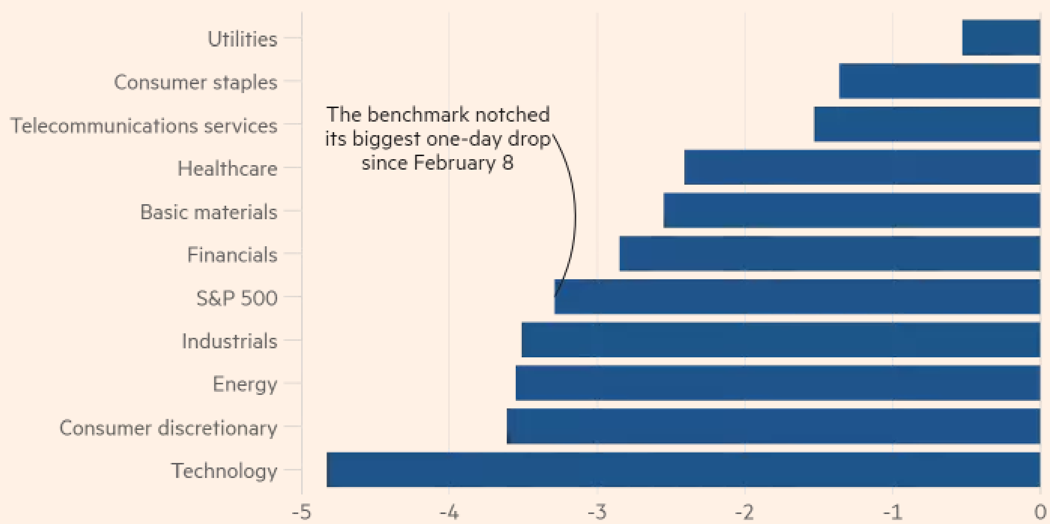
"This is much more interest-rate related than anything going on specifically with tech," said Ari Shrage, chief executive of Aliya Capital. "Interest rates are moving higher, so stocks that are the most expensive typically are the ones that roll over."

While tech companies such as Amazon, which dropped more than 6 per cent, led the way down, the selling was broad-based.

All 11 sectors in the S&P 500 closed lower, putting the index on track for its third straight week of losses for the first time since June 2016. Among industrial companies, Boeing lost 4.7 per cent and Caterpillar nearly 4 per cent. BlackRock, an investment manager, fell more than 7 per cent.

The sell-off came on the eve of the reporting season for third-quarter earnings. On Friday, JPMorgan, Citigroup, and Wells Fargo are set to deliver their results.

"It was much more about people taking profits than a panic," said JJ Kinahan, chief market strategist at TD Ameritrade. "Some investors decided they wanted to be on the sidelines to think about where they should be and what sectors they should own for the end of year. Will the bank CEOs on Friday paint a good picture for rest of year or a picture of extreme caution in terms of headwinds for the market, such as tariffs, dollar strength and energy prices "



Sources: Thomson Reuters Datastream, @_PeterWells

The day's biggest losers included in the so-called Faangs, the one-time darlings of bullish investors. Facebook was down more than 4 per cent for the day, bringing its drop in value for the year to more than 14 per cent.

Google parent Alphabet and Apple lost 4.6 per cent each. Netflix and Twitter were off by more than 8 per cent each. Semiconductors were also hard hit. Advanced Micro Devices lost more than 8 per cent and Nvidia dropped 7.5 per cent.

The Nasdaq 100 of the largest tech stocks dropped 4.4 per cent, its worst day since 2011.

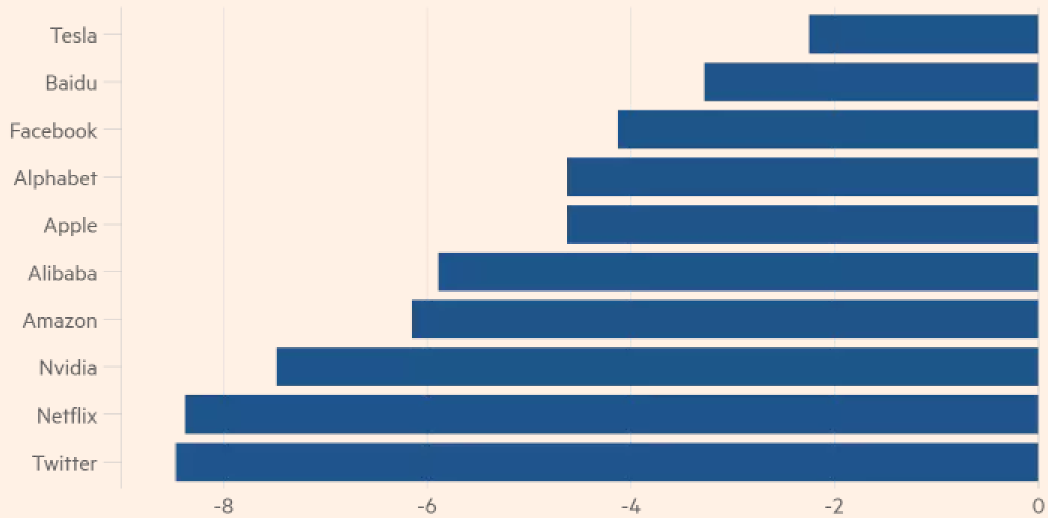
Markets data delayed at least 15 minutes
Source: Thomson Reuters

"Tech has been the leader all year. When you have big gains with valuations expanding, it doesn't take a whole lot for stocks to take a breather," said Peter Lazaroff, co-chief Investment officer at Plancorp. "It is pretty natural to see that they are the ones taking the fall a bit more than the broader market."

Feedback

NYSE Fang+ index

Member performance, %



Sources: Bloomberg, @_PeterWells
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Analysts and traders also pointed to algorithmic trading strategies such as "risk parity" for exacerbating the move lower in stocks. Historically, it is unusual for longer-dated, highly rated bonds to sell off in tandem with equities, and risk parity strategies are predicated on bond and equity prices moving in opposite directions.

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The twin declines on Wednesday worried investors, because so many portfolios are constructed with the assumption that when stocks do badly, bonds will do well, and vice versa.

They are "negatively correlated", in Wall Street jargon. But if the correlation between bonds and equities turn positive — as they broadly were in the stagflationary 1970s — then it will undermine the risk management models of many popular investment strategies.

Additional reporting by Demetri Sevastopulo in Washington and Robin Wigglesworth and Colby Smith in New York