Global conditions fuel Wall Street sell-off

By Nick Beams
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The wave of selling that hit Wall Street for the first two days of this week eased yesterday, as markets remained flat. It was significant, however, that gains made during the course of the day, which saw the Dow Jones index up by as much as 200 points, were lost by the close of trading.

The Dow shed a total of around 900 points on Monday and Tuesday, while the S&P 500 index dropped by 3.5 percent, with an 8.5 percent fall in the value of Apple, the world's largest company by market value.

The market has been trending down since the start of October, led largely by high-tech stocks, the so-called Faangs—Facebook, Amazon, Apple, Netflix and Google's parent company Alphabet—but this week the sell-off widened.

One factor appears to be that while companies have reported higher earnings and sales so far this year, there are doubts about whether this will continue in 2019 as the impact of the Trump administration's corporate and income tax cuts begins to wear off.

The fall in Apple, for example, has been triggered by cuts in the production of its three latest models, released in September, with the company saying it would no longer issue figures for individual unit sales. Companies that supply the tech giant have reported reduced orders for components in the new models.

Apple has fallen by more than 20 percent since its high in October, losing $265 billion in market value, more than the entire market capitalisation of firms such as the drug company Pfizer, the Wells Fargo bank and the retail firm Procter and Gamble.

Overall, the Faangs have lost $1 trillion in market value since their October peaks, equivalent to almost half the value of the companies that make up London's FTSE 100 index.

In another indication of the extent of the sell-off, the tech-heavy NASDAQ index has shed all the gains it made this year, a situation that is close to being replicated across the broader market.

While many causes are at work, the market turbulence is being fuelled by three broad global processes: signs of a slowing global economy after an upturn in 2017, the intensification of the trade war that centres on, but is not confined to, the conflict between the US and China, and tightening monetary conditions.

Last year, on the back of growth rate increases in a number of key global regions, the prospect was held out for "synchronised" world growth and a return to levels, if not reaching, then at least trending toward, those attained before the 2008 financial crisis. This has not eventuated. After a brief upturn, euro zone growth recorded its lowest level in the third quarter of 2018 for more than five years, with an actual contraction in the leading economy, Germany.

A further indicator of falling global demand and output is the fall in oil prices in recent weeks.

Following the 2008 crisis, the continued expansion of the Chinese economy, fuelled by government spending and a major expansion of credit, played a key role in propping up global capitalism, particularly commodity-exporting countries.

Now, China's growth rates are down to their lowest levels since 2009, with little sign of any upturn as the government and financial authorities try to rein in debt growth. Financial markets have also fallen sharply, with the Shanghai Composite Index down 27 percent for the year.

While the Trump administration's tariff measures have not yet had a major impact, the threat of their escalation hangs over the global economy. Senior US officials, such as US Trade Representative Robert Lighthizer, maintain that China must suffer more economic pain and bow to US demands.

Following the reports earlier this month that Donald Trump and Chinese President Xi Jinping had held a phone conversation on trade—after months of no communication between the two sides—and Trump's tweets that he was hopeful of a deal, there was some guarded optimism of at least a limited agreement when the two met at the G20 summit at the end of next week.

But with US Vice-President Mike Pence's attacks on China at the Asia Pacific Economic Cooperation (APEC) summit in Papua New Guinea last weekend, that is now considered unlikely, and the US will press ahead with an escalation of the 10 percent tariff on $200 billion worth of Chinese goods to 25 percent at the start of 2019.

The *Financial Times* reported yesterday that all eyes were now on the G20 meeting. "Combined with rising interest rates, clouds over global economic growth and political tensions elsewhere, investors are awaiting the meeting with a degree of trepidation," it said.

Tai Hui, JP Morgan Asset Management's chief Asia-Pacific market strategist, told the newspaper the divisions between the US and China revealed at the APEC meeting meant a "material breakthrough" on the trade tensions was "highly unlikely."

The G20 summit preparations indicate the organisers expect that trade conflicts will dominate the agenda. In an effort to appease the US, the final communiqué's initial draft omits a long-standing reference to resisting protectionism, while promising to "recognise the importance of the multilateral trading system" and work to "keep markets open and ensure a level playing field."

If no agreement is reached to at least delay the planned tariff hikes, this will have a major market impact, especially on high-tech companies because of fears that an intensified trade war will adversely affect both their global supply chains and markets.

The third major factor in the market turmoil is rising interest rates and tightening conditions. The bull-run on Wall Street, which started in March 2009, when the market reached its low point after the financial crisis, is now the longest in history. It has been sustained principally by the supply of ultra-cheap money by the US Federal Reserve and other major central banks. The slogan during previous sell-offs has been "buy the dips," based on the assumption that cheap credit would lead to an upturn.

But with the US Fed, together with the European Central Bank to a lesser extent, pulling back on cheap money policies, interest rates are starting to rise. According to an equity analyst cited by the *Wall Street Journal*, the "buy-the-dippers are getting concerned" and increasingly saying, "let's sell everything."

The Fed is expected to go ahead with a further 0.25 percent increase in its base rate when it meets next month and that expectation largely has been priced into market valuations. The key question will be whether, with official US unemployment rates at historic lows and fears that wages may start to rise, the Fed indicates that it will continue the rising-rate path next year.

If further rate rises coincide with a fall in revenues and profits as the Trump tax measures' effect wears off, this could be the trigger for a recession. JP Morgan Chase now rates the probability of a recession in 2019 at one in three, compared with its assessment of between 8 and 27 percent a year ago.

Interest rate increases and tightening credit conditions are affecting the stock market already. Bloomberg reported that for "investors with a sense of history the most stomach-churning spectacle has been the deterioration of credit," with a widening gap between the yield being demanded on corporate bonds and the return on US Treasuries.

Federal Reserve Bank of Minneapolis President Neel Kashkari, a long-time proponent of an easier monetary policy, has called for caution by the Fed. He told National Public Radio one of his concerns was that "if we preemptively raise interest rates, and it's not in fact necessary, we might be the cause of ending the expansion," thereby triggering the next recession.

If that were to occur, it would take place under uncharted conditions. No one knows what effect the unwinding of the historically unprecedented cheap money policies of the past decade could have both on financial markets and the economy as a whole.