January 23, 2008

US stocks climb back from early plunge

By Madlen Read

Wall Street struggled to steady itself on Tuesday, climbing back from an early plunge after the Federal Reserve cut interest rates in hopes of restoring stability to a faltering US economy.
The Dow Jones industrials, down 465 points at the start of the session, recovered to a loss of about 145 points.

The US markets joined a global selloff amid growing fears that a recession in the United States could send economies around the world into a downturn. Though stocks regained ground as investors digested the Fed's move to cut its benchmark federal funds rate by 0.75 percentage point and as bargain-hunters entered the market, trading remained volatile and the major indexes fluctuated sharply, at times approaching the break-even point before heading down again.

The Fed's move was unusual, coming between regularly scheduled meetings and just a week before its next gathering. But that created little, if any, optimism on Wall Street, particularly because stocks have been falling steeply for months because of the ongoing housing, mortgage and credit crisis and its impact on the overall economy.

The rate cut helped staunch the stock drop because "the equity markets are so used to the knee jerk reaction that if it's cheaper for companies to borrow, earnings will go up," said Daniel Alpert, managing director of Westwood Capital LLC. "But throwing more cheap money into the equation doesn't help the fact that we have a credit crisis on our hands."

With the housing and credit markets unlikely to turn around soon, and more disappointing economic news expected, investors were expected to keep shying away from stocks. And even before the cut was announced, no one believed lower rates alone would erase investors' concerns. For the market to truly gain a foothold, investors need to see strong economic data in the coming weeks and solid earnings reports and forecasts this week from big multinational companies like Microsoft Corp, AT&T Inc, Caterpillar Inc and Honeywell International Inc.

"If that doesn't happen, then all this is a short term bottom before a resumption of selling," said Peter Boockvar, equity strategist at Miller Tabak. US bonds were mixed, with investors seeking safer investments as stocks declined. The price of oil, meanwhile, fell amid expectations that a downturn would depress demand for energy. The Fed lowered the target federal funds rate, or the interest banks charge one another for overnight loans, to 3.50 per cent and the discount rate, the interest the Fed charges banks directly, to 4 per cent.

It can take months for an interest rate cut to work its way through the economy. In the short term, it makes borrowing cheaper, but the billions of dollars in failed mortgages over the past year have made lenders wary of writing loans to almost anyone - consumers or corporations.

And the heavy losses that banks and other financial institutions have suffered due to failed mortgages and related investments have raised questions about their stability.

In midday trading, the Dow was down 38.04, or 0.31 per cent, at 12,061.26. The Dow was last below 12,000 in March 2007. The broader Standard & Poor's 500 index was off 6.10, or 0.46 per cent, at 1,319.09, while the Nasdaq composite index fell 28.77, or 1.23 per cent, to 2,311.25.