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8,000 Is Low Enough

By Steve Schaefer, 10.10.08, 3:30 PM ET

Believe it or not Wall Street finished with just modest losses Friday, after a furious rally in the final hour of trading nearly ended in positive territory

After briefly cracking the 8,000 barrier a few times during the session, the Dow appeared to find resistance at the level. Liquidations by large investors were the likely driver for an early drop and a mostly-depressed day, as companies like Exxon Mobil, with one of the strongest balance sheets in corporate America, fell despite little fundamental impetus. Still, by the closing bell the sellers had already played out their string and buying interest surged back into the market.

The Dow Jones industrial averaged closed with a loss of 128 points, or 1.5%, to 8,451; and the S&P 500 slipped 11 points, or 1.2%, to 899; while the Nasdaq eked out a 4 point, or 0.3%, gain, to 1,650. The modest decline rounded out what has been a brutal week. Over the past five days the Dow lost 18.2%, and the blue-chip index is currently 40.3% below its all-time high set Oct. 9, 2007. The S&P 500 shed 18.2% for the week, while the Nasdaq lost 15.3%.

Dry powder was the name of the game, as investors pulled out of stocks and plowed money into safer parking spots, like short-maturity Treasury securities. Yields dropped precipitously on the shorter end of the curve, with the one month T-bill returning 0.06%, down from 0.12% Thursday, and the three-month T-bill yield up 0.22%, from 0.63%. Two-year note yields also fell, down to 1.61% from 1.73%, but on the longer end the 10-year note offered 3.86%, up from 3.84%.

Westwood Capital managing director Dan Alpert said the credit squeeze is forcing investors and companies alike to deal with debt issues by liquidating positions and shoring up capital. While Alpert believes the day's wild trading can be attribute to panic, he said the risk aversion to financials is warranted. With proposals for direct capital injections into banks by the government gaining steam, Alpert said it makes sense for investors to see what price the government will offer before making their own bets in the sector.

The explanation has an interesting application in the case of Morgan Stanley, which has seen its share price shattered by concerns that its deal to receive a $9.0 billion injection from Japan's Mitsubishi UFJ Financial Group may not happen. Despite frequent reassurances for both sides that the deal will close Oct. 14, the investment calls for a price of $25.25 a share, a 232.2% premium with Morgan Stanley down $4.85, or 39.0%, to $7.60 Friday.

If Mitsubishi has any wiggle room to lower its price, Morgan Stanley likely has no choice but to accept it, Alpert says. "If it [Mitsubishi] tries to negotiate downward, Morgan Stanley needs to find a price to make it work, because it needs the capital."

One bright spot for Morgan Stanley is that is has far less exposure to Lehman Brothers Holdings than the multibillion-dollar estimates that had recently rattled investors.

An auction of Lehman's credit default swaps priced lower than expected, but the market appeared unfazed by the result, holding at its pre-announcement levels. The value was set at 8.625 cents on the dollar, below initial indications of 9.75 cents on the dollar.

Meanwhile, short-term funding markets appeared to show some indications of healing. The commercial paper market was showing signs of life, while the overnight London interbank offered rate was halved Friday, falling to 2.47%, from 5.09%, on Thursday.

Oil prices and the euro each hit one-year lows Friday. Crude dropped $8.89 to settle at $77.70 a barrel, while the 15-nation euro fell to $1.3573, from $1.3609, Thursday.

In the midst of Friday morning's turbulence, President Bush addressed the nation. "We all share a determination to solve this problem and that is exactly what we are going to do," he said in remarks at the White House Rose Garden Friday morning.

The president ran through a list of measures the government is using to rescue the markets, including the recently passed $700.0 billion bailout plan, coordinated interest rate cuts worldwide, the Federal Reserve's efforts actions to provide liquidity to banks and the commercial paper market, and the SEC's efforts to prevent the spreading of false information about companies.

"The federal government has a comprehensive strategy and the tools necessary to address the challenges in our economy," Bush said.

Over the weekend, finance ministers from the Group of Seven (U.S., U.K. Germany, France, Japan, Italy and Canada) will gather to discuss ways to ease the unprecedented and pervasive stress on financial markets around the world.