Watch bond market, don't panic, experts say

Friday's drop could signal long-awaited correction

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USA TODAY

After the worst weekly stock market drop in two years, anxious investors shaken by the end of a long period of market calm will kick off a new week on Monday bracing for more turbulence.

Stocks got slammed last week, with the broad market plunging 3.9%. The sudden free fall snapped the S&P 500 stock index's longest stretch ever without suffering a 3% dip from a high.

The return of wild market swings, known as "volatility," provided a wake-up call for investors, reminding them that stocks don't just go up. The recent trading turmoil could be a signal that the long-awaited correction — a 10% drop — that's been warned about by market skeptics could now be underway, many money managers, economists and finance professors say.

"The timing is uncertain, but a correction is coming," says Sung Won Sohn,

See STOCKS, Page 2B

Anthony Matesic watches numbers from the floor of the New York Stock Exchange on Friday as stocks closed sharply lower. RICHARD DREW/AP

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Stocks

Continued from Page 1B

a professor at California State University-Channel Islands.

Periodic market drops normally occur roughly once a year. They are viewed as healthy because they clean out froth, or overly exuberant investment.

However, the U.S. financial market hasn't suffered a setback as big as last week's since February 2016. In fact, the market hasn't suffered a 5% drop, or pullback, since June 2016, when England's Brexit vote to leave the European Union shocked investors.

The sudden rockiness on Wall Street was set in motion by fears that the record low-interest rates that have powered stocks and the economy for nearly nine years may be ending as the economy and job market gain strength.

While the recent sell-off may have more room to continue, Nick Sargen, the chief investment officer at Fort Washington Investment Advisors, doesn't see the swoon morphing into a full-fledged bear market, or 20% drop. That's mainly because business conditions remain strong and "the risk of recession is low," he says.

Wall Street pros say there are a few signals they will assess to gauge how long the downward price action likely will last:

Watch the bond market

Last week, data showing wage growth for hourly workers rose at the fastest pace since 2009 caused a sell-off in bonds, pushing the yield on the 10-year Treasury above 2.85%, its highest level in four years. If the climb continues and tops 3%, that could cause more market angst.

"It's a bit of a psychological level that we haven't broken through since late 2013," says Sargen.

Higher borrowing costs tend to slow economic activity. Bond yields likely need to stop sharp rises for stocks to stabilize, says Bob Doll, chief equity strategist at Nuveen Asset Management.

Watch the stock market

What investors and consumers think the market will do and what it actually does are different things.

Before making any rash investment decisions, keep emotions in check and see how things play out in the coming days, says Lindsey Bell, investment strategist at New York-based investment research firm CFRA.

"Wait to see how the market reacts on Monday," she says.

Also keep an eye on key levels of major stock indexes that market pros watch. Mark Arbeter, who heads Arbeter Investments, says the market dip presents a buying opportunity. After last week's fall, the S&P 500, which closed at 2762 Friday, is close to the 2750 level that he has been targeting as his "first buy area."

Other market experts say it will be a negative sign if utilities — a sector considered defensive in nature — emerge as a market leader in response to investors seeking safety.

Watch the economy

Business around the world remains strong and should continue to give investors a reason to invest in stocks once the rough patch passes, says Thorne Perkin, president of Papamarkou Wellner Asset Management in New York.

"Strong earnings, government stimulus and a broadly improving global economy will bolster the equity case and keep prices moving higher," Perkin predicts.