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WAKE-UP CALL

Plunge in China, bad U.S. economic news spook world's markets -- is it just a blip?

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Wall Street's worst meltdown in five years, in which major stock indexes plunged more than 3 percent on Tuesday, raised questions about whether the sell-off is a short-term phenomenon or the beginning of a significant market downturn, analysts said.

The day's wave of selling, which wiped out $600 billion in market value, prompted a fierce debate over the direction of the market from this point.

The U.S. stock market has kept climbing despite a softening economy and a growing accumulation of problems, such as the weak housing sector. Until now, investors have largely shrugged off such dangers. The market's tanking could rattle investors out of their complacency, leading to a significant downturn.

"This is a wake-up call to investors that stocks and other asset classes are risky," said Rich Golinski, a principal at San Francisco's Bingham, Osborn and Scarborough, which manages $1.7 billion for high-net-worth individuals. "People who were underestimating the riskiness of their investments are now realizing they are overexposed, and there will be some selling."

A day after its 8.8 percent free-fall set off a worldwide selling frenzy Tuesday, China's Shanghai Composite Index recovered today, gaining 3.9 percent to close at 2,881.07. Elsewhere, though, the sell-off continued as shares tumbled 2.9 percent in Tokyo, 7.9 percent in the Philippines, 6 percent in Malaysia and 5.2 percent in Indonesia. Australian stocks closed down 2.7 percent. The region's biggest bourse, the Tokyo Stock Exchange, saw its Nikkei 225 stock index fall 515.80 points, to 17,604.12.

After months of steady gains in U.S. stock prices, some experts thought the market needed a jolt of reality.
U.S. stocks "have been way, way overdue for a correction," said Barry Ritholtz, chief market strategist for Ritholtz Research & Analytics, told the Internet news service MarketWatch. "There is a fundamental slowdown of the economy, which investors have ignored for too long."

Despite Tuesday's rout, many analysts were sanguine that the damage would be short-lived.

"Is it a blip?" said Joseph LaVorgna, chief U.S. economist at Deutsche Bank Securities in New York. "Our view is the equity market will be up for the year. One day will not change that."

James Paulsen, chief investment strategist at Wells Capital Management in Minneapolis, said, "My suspicion is that it won't last very long." The market has not been volatile lately, he said, so many traders were primed for that to change. "So many people were waiting on (increased volatility) that it magnifies it somewhat. They're waiting for any bad news so they can dump."

Paulsen said he didn't think there has been a significant negative change in fundamental economic factors.

"It's a feeding frenzy of fear," he said. "I don't see anything fundamentally horrible or wrong in the world anywhere at the moment. It's not like there has been a default or currency collapse so I think it could be fairly quickly resolved."

Tuesday's Wall Street plunge was sparked by a spate of downbeat events around the globe that spooked traders, starting with a nearly 9 percent plunge in China's stock market. That was followed by disappointing reports on U.S. durable goods orders and real estate sales. Investors also are wary of recent sharp rises in sour loans in the subprime mortgage market, which provides home loans to borrowers with troubled credit records.

Compounding the financial anxiety, former Federal Reserve Chairman Alan Greenspan, whose utterances are still treated with the same reverence they were during his almost two-decade term, said in a speech Monday that it is "possible" the U.S. economy could slip into recession this year.

"On top of that, someone tries to blow up (Vice President Dick) Cheney," said Scott Merritt, U.S. equity strategist with J.P. Morgan Asset Management in New York, referring to a suicide bombing in Afghanistan. "It was a banner bad news day."

The Dow toppled 416.02 since Monday's close, or 3.29 percent to close at 12,216.24. It is now in negative territory for the year. At one point on Tuesday, the Dow was down as much as 546.02, but it recovered some ground in the final hour of trading.
The Nasdaq composite index dropped 96.65 since Monday's close to 2,407.86, down 3.86 percent. The Standard & Poor's 500 Index fell 50.33 points to 1,399.04, off 3.47 percent.

The day's events underscored the increasing interconnectedness of global markets.

The first catalyst was the Chinese government's statement that it would crack down on stock speculation, which triggered an agonizing sell-off in that country's market. That plunge in turn sparked sell-offs in the United Kingdom, German and French markets, as well as on Wall Street.

"The psychology is, there is only one stock market across the world. It happens to be traded in a bunch of places, but it moves increasingly in lockstep," said J.P. Morgan's Merritt. But the Chinese market needed a correction and the government's clampdown on speculation seemed appropriate, he and others said.

"China is an extremely frothy and risky market," said Richard Welty, chief investment officer at Welty/Solari Capital Advisors, LLC in Lafayette. "The Chinese people are known to love to gamble. They recently were using credit cards to buy stocks and (a financial instrument similar to) equity lines of credit on their homes. Home mortgages are fairly new in China anyway. Using a line of credit on (your home) to buy stocks is not a good idea."

One factor that intensified traders' fears during the day turned out to be caused by a technical glitch. At around 3 p.m. Eastern time, the Dow sustained a jaw-dropping freefall, losing about 200 points of value in a minute. The reason was that Dow Jones computers had become overwhelmed by the surge of orders. When the company switched to a backup system, it suddenly processed backlogged trades, causing the rapid plunge. The actual stock prices remained accurate, but their fall should have been spread out over a longer period of time.

Michal Ann Strahilevitz, an associate professor of marketing at Golden Gate University in San Francisco, said Tuesday's events show how investors have a herd instinct.

"When you see things drop that fast, it's panic mentality," she said. "My guess is (today) is not going to be a pretty day, but probably not as ugly as (Tuesday)."