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Stocks slump despite bank rescue

Dow suffers worst weekly performance since the week after 9/11 attacks, as investors remain fearful about the economy.

By Alexandra Twin, CNNMoney.com senior writer
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NEW YORK (CNNMoney.com) -- Stocks slumped Friday, as a brutal week ended with President Bush signing the historic $700 billion bailout plan after weeks of contentious debate.

Credit markets remained frozen, despite the vote, with two measures of bank jitters rising to record highs. Investors also looked to Wells Fargo's planned purchase of Wachovia and a dismal job market report.

The Dow Jones industrial average (INDU) lost 1.5% Friday and 7.3% for the week. On a point basis, the Dow lost 818 points this week, its biggest weekly point loss in seven years and the third biggest weekly loss ever.

The Standard & Poor's 500 (SPX) index lost 1.4% Friday and 9.4% for the week. On a point basis, the S&P lost 114 points, the worst weekly point loss in seven years and the third biggest weekly loss ever.

The Nasdaq composite (COMP) lost 1.5% Friday and 10.8% for the week. The 10.8% decline was the worst in seven years and fifth worst ever. But the weekly point drop of 236 points fell outside the ten worst in history.

Wall Street rallied ahead of the early afternoon vote - with the Dow up as much as 313 points - as investors bet the House would pass the modified version of the bill after defeating a similar measure Monday.

But once the House voted 263-171 to pass the bill, which would buy illiquid securities in order to unfreeze credit markets - stocks gave up gains. News that President Bush signed it into law failed to stop the downtrend.

Wall Street was probably taking a classic "buy the rumor, sell the news" approach, analysts said. Additionally, markets may have implied that even with the new law, the economy remains under duress.

"It's like a heart that's had a heart attack and, while it's recovering, it's still dealing with muscle damage," said Scott Anderson, senior economist at Wells Fargo.

Anderson thinks the economy is in a recession now and will remain in one until at least this time next year.

"Over time, the Treasury will be buying the bad assets, and we'll see what kind of impact that has," said Stephen Stanley, chief economist at RBS Greenwich Capital. "But the damage has already been done to the real economy."

Stanley said banks won't be more willing to lend to each other or consumers anytime soon. The absence of ready capital has stalled the financial system and hurt consumers.

The Dow plunged Thursday as frozen credit markets added to fears that the House might shoot down the bill. After Monday's failed vote, the Dow ended down a record 777 points. (Full story)

"This bill should result in more confidence in the financial markets, but now that it's been passed, the hard work begins," said Ted Weisberg, NYSE floor trader at Seaport Securities.

Credit markets: Measures of bank nervousness hit record levels Friday, even after the bill was signed into law.

The 3-month Libor - the rate banks charge each other to borrow for three months - rose to 4.33% from 4.21% Thursday, the highest level since January, according to Bloomberg.

The difference between the 3-month Libor and the Overnight Index Swaps rallied to an all-time high of 2.86%. The Libor-OIS spread measures how much cash is available for lending between banks and is used by banks to determine rates. The bigger the spread, the less cash is available.

The TED spread, which is the difference between 3-month Libor and what the Treasury pays for a 3-month loan, briefly hit an all-time high of 3.88%, before settling at 3.87%.

The wider the spread, the more reluctant banks are to lend to each other rather than from the federal government. When markets are fairly calm, banks charge each other premiums that are not much higher than the U.S. government.

The yield on the 3-month Treasury bill, seen as the safest place to put money in the short term, fell to 0.49% from 0.68% late Thursday, with investors willing to take a piddling return on their money rather than risk stocks. On Monday, the yield fell to 0.14% as panic gripped the markets. Last month, the 3-month bill skidded to a 68-year low around 0%. (Full story)

Long-term government debt prices gained and the yields slipped. The benchmark 10-year Treasury note rose 6/32, sending the corresponding yield down to 3.60% from 3.62% late Thursday. Treasury prices and yields move in opposite directions.

Wachovia: Investors also eyed Wachovia (WB, Fortune 500)'s surprise news that it has accepted Wells Fargo (WFC, Fortune 500)'s $15.1 billion all-stock bid.

Earlier this week, Wachovia had pledged to sell just its banking operations to Citigroup (C, Fortune 500) in a deal that would have required the involvement of the federal government. But a deal that would keep Wachovia intact was better for the company, its CEO said. (Full story)

However, Citi appears to be ready to fight for Wachovia, issuing a statement that Wells Fargo should end the deal as it is in breach of Citi's contract.

Wachovia rallied 58.8% in active New York Stock Exchange trade, while Wells Fargo fell 1.7%. Citigroup fell 18.4% on investor disappointment that it couldn't seal the deal with Wachovia.

The broader financial sector tumbled, erasing gains accrued ahead of the vote.

Market breadth was negative. On the New York Stock Exchange, losers topped winners almost two to one on volume of 1.4 billion shares. On the Nasdaq, decliners beat advancers five to two as 2.55 billion shares changed hands.

Jobs report: The bailout focus and Wachovia news helped temper worries about a government report that showed the biggest drop in jobs since 2003.

Employers cut 159,000 jobs from the payrolls in September, far exceeding economists' forecasts for 105,000 net losses, according to Briefing.com. It was the ninth-straight month the economy has lost jobs, bringing the 2008 tally up to 760,000 jobs lost.

The unemployment rate, generated by a separate survey, stayed at 6.1%, unchanged from August and in-line with forecasts. (Full story)

In other economic news, the Institute for Supply Management's reading on the services sector of the economy fell to 50.2 in September from 50.6 in August. That topped forecasts for a drop to 50, which is the measure for expansion in the index.

AIG: The insurance company said it would sell some of its business to pay back the federal government the $61 billion in loans it has taken, after it narrowly avoided collapse last month. AIG (AIG, Fortune 500) shares gave up morning gains and ended 3.5% lower. (Full story)

Oil and gold: Oil prices were lower, with U.S. light crude oil for November delivery settling down 9 cents to $93.88 a barrel on the New York Mercantile Exchange. (Full story)

Oil prices have been choppy over the last few weeks amid the financial market crisis. Bets that a slowing global economy means slower oil demand have weighed on prices, following a peak of $147.27 a barrel on July 11. But the recent stock market turmoil has also made investors anxious for safer investments such as oil, gold and other commodities.

COMEX gold for December delivery fell $11.10 to $833.20 an ounce.

Other markets: In currency trading, the dollar gained against the euro and fell versus the yen.

Gas prices fell for the 16th day in a row, according to a nationwide survey of credit card activity.

In global trading, European markets rose, while Asian markets ended lower.

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