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Stocks Close Down on Fed's Decision to Sell Corporate Bonds

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The offices of the Canary Wharf financial district are seen on May 08, 2021 in London, England.
Getty Images

Stocks closed down on Thursday, with technology shares underperforming on upbeat employment data and the Federal Reserve's decision to start selling the corporate bonds it bought during the pandemic last year.

The three major indexes all fell—the Dow Jones Industrial Average by 23 points, or 0.07%, the S&P 500 by 0.36% and the Nasdaq Composite by 1%.

Figures on hiring in the private sector from ADP and data on initial claims for unemployment benefits both came in strong as investors await the government's key jobs data on Friday. ADP said the private sector added 978,000 jobs, while initial claims for unemployment benefits fell to 385,000, moving below 400,000 for the first time since the start of the pandemic.

But the Fed will begin selling more than $13 billion of corporate bonds, a sign that it is becoming less accommodative. The central bank had bought bonds to help keep corporate borrowing costs down so companies could access capital during the pandemic. The move comes shortly after the Fed said it may soon begin discussing a larger reduction to its bond-purchasing program. Higher bond yields are typically seen as a negative for stock valuations.

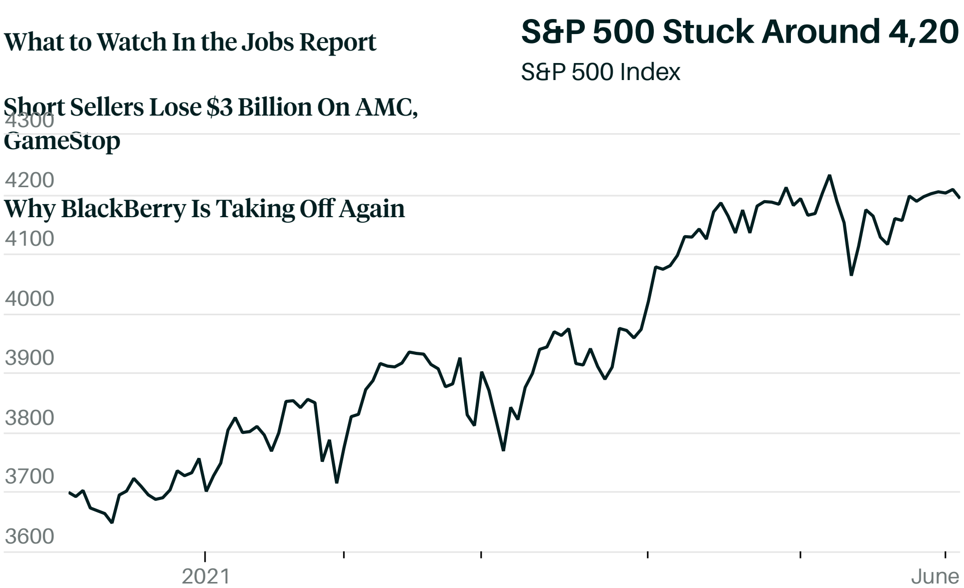
The Fed's bond sales are small, but its message that it is altering policy is strong. "The announcement today to wind down the Secondary Market Corporate Credit Facility portfolio is very negative for risk assets," writes Hans Mikkelsen, credit strategist at Bank of America. "It should take very little selling to convince investors the tightening cycle is under way."

Value stocks were outperforming, while growth shares were falling. Value names are largely more sensitive to changes in the economic outlook—and the Dow is heavily-weighted toward value. Growth stocks see an outsize hit to valuation upon evidence of higher bond yields to come.

Investors are indeed monitoring the Fed's moves and growth shares. "Growth stocks, particularly technology and small caps, have been in a trading range since money [supply] growth rolled over," writes Jim Paulsen, chief investment strategist at Leuthold

Group. Simply put, the growth in the money supply will keep falling as the Fed reigns in the size of its programs, which would pressure tech stocks. To Paulsen's point, the Nasdaq, home to many high-growth technology names, is down more than 3% since mid February, when the growth of the money supply began decelerating, according to Lethold data. The Dow, by comparison, is up more than 9%.

In Asia, the Nikkei 225 ended 0.4% higher while the Hang Seng fell 1.1%. The Stoxx Europe 600, which ended at a record high on Wednesday, slipped 0.1%.



Source: FactSet

A separate focus for the market is the possibility for bipartisan infrastructure spending package after President Joe Biden and West Virginia Sen. Shelley Moore Capito, a Republican, agreed to hold another round of talks on Friday.

While the broader market is sticking to a tight range, the so-called meme stocks continue to attract attention. Shares of movie chain AMC Entertainment (ticker: AMC) fell 17.92% after a 95% gain on Wednesday.

"The stock is up well over 2,000% so far this year and is trading at levels that are entirely disconnected from fundamentals," said David Trainer, chief executive of New Constructs, an investment research firm. "We think AMC Entertainment's stock is worth $0 per share, given its weak earnings, dilution from recent stock offerings and mountain of debt."

FireEye (FEYE) slid17.62% after the cybersecurity firm said it will sell its products business to Symphony Technology Group for $1.2 billion in cash and keep its Mandiant Solutions software business, whose name it will adopt.

Elastic (ESTC) stock rose 10.02% after reporting a loss of 8 cents a share for its latest quarter, beating forecasts for a loss of 16 cents a share, on sales of $177 million, above expectations for $158 million.

Tilray (TLRY) stock gained 3.79% after getting upgraded to Overweight from Neutral at Cantor Fitzgerald.

Take-Two Interactive Software (TTWO) stock gained 0.46% after getting upgraded to Buy from Hold at Jefferies.

Apa (APA) stock fell 1.11% after getting downgraded to Equal Weight from Overweight at Barclays.

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