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When Wall Street Writes Its Own Rules

By Sheelah Kolhatkar
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On July 25, 2013, a high-ranking federal law enforcement officer took a public stand against malfeasance on Wall Street. Preet Bharara, then the United States attorney for the Southern District of New York, held a news conference to announce one of the largest Wall Street criminal cases the American justice system had ever seen.

Mr. Bharara's office had just indicted the multibillion-dollar hedge fund firm SAC Capital Advisors, charging it with wire fraud and insider trading. Standing before a row of television cameras, Mr. Bharara described the case in momentous terms, saying that it involved illegal trading that was "substantial, pervasive and on a scale without precedent in the history of hedge funds." His legal action that day, he assured the public, would send a strong message to the financial industry that cheating was not acceptable and that prosecutors and regulators would take swift action when behavior crossed the line.

Steven A. Cohen, the founder of SAC and one of the world's wealthiest men, was never criminally charged, but his company would end up paying $1.8 billion in civil and criminal fines, one of the largest settlements of its kind. He denied any culpability, but his reputation was still badly — some might argue irreparably — damaged. Eight of his former employees were charged by the government, and six pleaded guilty (a few later had their convictions or guilty pleas dismissed). Mr. Cohen was required to shut his fund down and was prohibited from managing outside investors' money until 2018.

Now, with the prohibition having expired in December, Mr. Cohen has been raising money from investors and is set to start a new hedge fund. He'll find himself in an environment very different from the one he last operated in. His resurrection arrives as Wall Street regulation is under assault and financiers are directing tax policy and other aspects of the economy — often to the benefit of their own industry. Mr. Cohen is a powerful symbol of Wall Street's resurgence under President Trump.

As the **stock market** lurched through its stomach-turning swings over the past week, it was hard not to worry that Wall Street could once again torpedo an otherwise healthy economy and to think about how little Mr. Trump and his Congress have done to prepare for such a possibility. **Stock market** turbulence typically prompts calls for smart and stringent financial regulation, which is not part of the Trump agenda. One of Mr. Trump's first acts as president was to fire Mr. Bharara, who made prosecuting Wall Street crime one of his priorities. Mr. Trump has also given many gifts to people like Mr. Cohen.

On the presidential campaign trail, Mr. Trump made promises to help working-class Americans — the "forgotten men and women" who have seen their opportunities for meaningful economic advancement decline over the past two decades, even as those at the top of the economic ladder have become even wealthier. Once in office, he abandoned many of those promises. Instead, he has placed the considerations of high finance at the top of his priorities, far exceeding what even his friends at big banks, hedge funds and private equity firms could have hoped for.

The most potent evidence may be found in the handling of the Consumer Financial Protection Bureau, the agency created in the aftermath of the 2008 financial crisis to protect consumers against unfair practices by banks, credit card companies and other financial institutions. Its first permanent director, the former Ohio attorney general Richard Cordray, ran the agency aggressively, to the loud protest of the banking industry and its Republican allies in Congress.

By the end of 2016, the bureau reported, it had recovered $12 billion for wronged consumers. Most famously, it brought charges over some of the most egregious financial abuse in recent memory, fining Wells Fargo Bank $100 million after it was found to have created a high-pressure sales culture that drove employees to open up more than two million accounts that customers hadn't asked for. The bureau also, through civil lawsuits and new rules, went after the payday lending industry, with the aim of protecting low income borrowers from becoming trapped by ballooning debt.

After Mr. Cordray's departure in November, Mr. Trump replaced him with the White House budget director, Mick Mulvaney, who once described the agency as a "joke." Mr. Mulvaney immediately started cutting back its power. The agency must ask for new funding each quarter; its most recent request was for $0, which suggests that he intends to starve it of cash.

There are other signs of Wall Street's rising influence. The new tax act passed by Mr. Trump's party includes an array of benefits for the investor class. During the campaign, Mr. Trump promised to eliminate the "carried interest" loophole, which gives many hedge fund and private equity fund managers tax rates that are lower than those of most people who pay income tax. He declared that hedge fund managers were "getting away with murder" through their extra-low taxes.

Yet somehow, the loophole remained untouched by the Republican tax overhaul, which stunned even some of President Trump's conservative advisers ("I don't know what happened," the economist Larry Kudlow told The New York Times. "I don't know how that thing survived"). Similarly, the tax plan promises its greatest tax cuts to corporations, with much of the benefit likely to flow to their shareholders. America's largest banks, like JPMorgan Chase, Citigroup and Wells Fargo, are predicting billions of dollars of increased profits.

Regulators who police the **financial markets** have been told in ways that are subtle and not so subtle to pull back on aggressive enforcement. Republicans, with the help of some Democrats, are taking steps to weaken the Dodd-Frank Act, passed in 2010 with the intent of making the financial system safer and of discouraging certain kinds of risk-taking by banks and other financial firms.

There were flaws in the legislation, to be sure. But Republicans have been pledging to get rid of it almost from the moment it was passed, arguing that it was discouraging banks from making loans and choking small banks with unnecessary rules. Mr. Trump has said Dodd-Frank is a "disaster," though he offered no evidence it was true. Now the Senate appears to be on a path to passing a bill that would loosen the rules considerably and excuse most banks, aside from those with $250 billion or more in assets, from the restrictions.

Into this environment comes Mr. Cohen, promising to generate dazzling profits for investors once again. Mr. Trump has lowered his taxes and lessened the chances that pesky market rules will hamper his appetite for taking risk. During his money-management hiatus, Mr. Cohen spent time at his estates in Greenwich, Conn., and East Hampton, N.Y., and made eye-popping art acquisitions, dropping $141.3 million, including fees, on a Giacometti sculpture. In this anything-goes-on-Wall-Street Trump era, why shouldn't he manage your money as well?

Sheelah Kolhatkar is a staff writer at The New Yorker and the author of "Black Edge: Inside Information, Dirty Money and the Quest to Bring Down the Most Wanted Man on Wall Street."

Steven A. Cohen, former head of a hedge fund, and his wife, Alex. A 2013 fraud scandal forced Mr. Cohen out of money management for several years, but he now stands to benefit in a new regulatory climate. | Gillian Laub

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The New York Times

Contributing Op-Ed Writer
Opinion
The G.O.P. Is Flirting With Fiscal Disaster

By Steven Rattner
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In August 2015, the leading Washington budget watchdog predicted that the federal deficit would total about $600 billion the next year.

Now, just about two and a half years later, the projected gap for 2019 has grown to $1.2 trillion, in large part because of a boisterous round of tax cuts and spending increases. And if history is any guide, when the books close, the final number will be higher.

That amounts to a shortfall that will rival the deficits of a decade ago, when the economy was struggling to recover from the financial crisis and ensuing recession.

But while fiscal stimulus to restore economic growth has merit, staggering deficits in the ninth year of a recovery, with unemployment down to 4.1 percent, make no sense.

In addition to piling more debt onto the current $20 trillion of outstanding obligations, today's mounting gap between revenues and expenses is already contributing to higher interest rates and the shakiness in the **stock market**.

Leading the charge into rising amounts of red ink have been the Trump administration and Republicans in Congress.

Yes, blame for what is likely to be $15 trillion of added debt over the next 10 years should be placed squarely on the self-proclaimed party of fiscal responsibility.

"The level of national debt is dangerous and unacceptable," the Senate majority leader, Mitch McConnell, said in 2016. Referring to President Obama's stimulus program, he added, "We borrowed $1 trillion and nobody could find that it did much of anything."

That was then and this is now.

On top of insisting that the nation needed tax cuts that could total $2.1 trillion over the next decade, the Republicans clamored for large increases in military spending. As the price for their cooperation, the Democrats won an equal increase in domestic spending.

Perhaps I shouldn't be surprised, but that's just not responsible governing. While I'm all for meeting pressing needs, as part of doing so, both the White House and the Congress have an obligation to find other savings or sources of revenues. Just like every household and business must.

I recognize that those of us who have warned of the ominous consequences of deficit and debt have yet to be proven right by a market crisis or the like. And the current gyrations in both stocks and bonds may not turn out to constitute that proof.

However, never in the 35 years since Ronald Reagan managed to eradicate fear of deficits from the national psyche have we flirted so aggressively with potential fiscal disaster.

For one thing, on present course and speed, deficits of more than $1 trillion will persist indefinitely. Indeed, if current policies are maintained, the gap would exceed $2 trillion by 2027, according to calculations by the Committee for a Responsible Federal Budget.

That would mean that the amount of debt relative to the size of our economy (the ratio of debt to gross domestic product) could reach a record 109 percent by 2027, exceeding even post-World War II levels.

For another, for the first time since at least the 1960s, we have thrown a deficit log onto a fire that was already burning briskly. That Vietnam War era decision — that we could have both guns and butter — contributed meaningfully to the raging inflation that erupted a few years later.

Although inflation has been quiescent so far in this recovery, potential pressure from rising wages has begun to appear, particularly in last week's unemployment report.

While we all want to see pay go up, particularly for working-class Americans, excessive wage increases can become excessive price increases, which would in turn force the Federal Reserve to increase interest rates faster than it would otherwise.

The bond market, which can serve as a kind of early warning signal of overheating, has been signaling concerns for several weeks. The yield on **10 year Treasury** notes, which had been loitering around 2.35 percent, has jumped to 2.8 percent.

That may not sound like much, but in the world of bonds, rates generally don't move that far that fast. Importantly, higher interest rates are the enemy of stock prices. As yields rise, investors begin to shift money from equities to debt, depressing valuations of the former. That may well be a part of what is now occurring.

Having lived for nearly 15 years with high deficits and low inflation, Americans may have become inured to the risks of bad budget policy.

As unattractive as the policy options are (essentially, raising taxes or finding spending that we are willing to cut), we would all be well advised to take on the challenge before it is too late.

Steven Rattner, who was a counselor in the Obama Treasury Department, is a Wall Street executive and a contributing opinion writer.

Mitch McConnell, the Senate majority leader, on Capitol Hill yesterday. In 2016, he said that the "level of national debt is dangerous and unacceptable." | Erin Schaff for The New York Times

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The New York Times

U.S.; Politics
Republicans Learn to Love Deficit Spending They Once Loathed

By Alan Rappeport
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WASHINGTON — Big government is officially back in style.

Republicans propelled themselves to power in Washington by promising an end to fiscal recklessness. They are now embracing the kind of free spending and budget deficits they once claimed to loathe.

On Friday, Congress passed a bipartisan spending deal that blows through the caps imposed by the 2011 Budget Control Act, unlocking $300 billion in additional spending for the military and domestic programs over the next two years. That comes on top of last year's $1.5 trillion tax cut package and as the White House prepares to unveil on Monday a $1.5 trillion infrastructure plan that would require $200 billion in government funding.

While the White House says it plans to offset that $200 billion through unspecified cuts, none of the other spending is paid for at a time when the nation's debt already tops $20 trillion.

The long-term implications of all this borrowing put the United States on track to ultimately owe more to its creditors than the economy produces over the course of a year. The nonpartisan Committee for a Responsible Federal Budget projects that the United States will run $2 trillion annual budget deficits by 2027 and have a debt-to-gross domestic product ratio of 105 percent — a level not seen since the end of World War II.

"With this deal, we will experience trillion-dollar deficits permanently," said Andy Roth, vice president of the conservative Club for Growth. "That sort of behavior, the last time I checked, is not in the Republican platform."

The seeds of this ballooning debt load are already taking root — the Treasury Department said last month that it expects to borrow $955 billion this fiscal year and more than $1 trillion in both 2019 and 2020. That money appears set to get only more expensive to borrow, as the Federal Reserve looks to continue raising interest rates and investors demand higher returns from an increasingly debt-laden government.

Indeed, the borrowing spree is contributing to recent **volatility** in **financial markets**, as investors fret that the additional fiscal stimulus, paired with a strengthening economy, could fuel inflation and translate into higher interest rates more quickly than anticipated. Major stock indexes dropped sharply again late Thursday afternoon, falling into a market correction, or a drop of more than 10 percent from their peak, largely on comments from the Bank of England that it might raise interest rates sooner and higher as it looks to fend off possible inflation. Investors poured into bonds in a flight to safety, pushing the yield on the **10**-**year Treasury** bill to a four-year high of 2.88 percent.

For many Republicans, backing the budget agreement is a break with conservative fiscal orthodoxy that carries risk going into the midterm elections. The party's professed commitment to limited government and deficit reduction helped Republicans regain control of the House and Senate during the Obama administration and also helped President Trump win election, with the candidate promising to get federal spending under control.

Last May, the Trump administration released a budget projecting the United States would swing from a deficit of $440 billion in 2018 to a surplus of $16 billion in 2027. The budget called for deep cuts to domestic programs and a robust increase in military spending.

Instead, the opposite has happened as Washington has opened the spending spigot in ways once unimaginable to the Republicans' fiscal discipline wing.

Some budget experts have pointed out that the budget deal, which Mr. Trump supports, is more costly than the fiscal plan that Hillary Clinton proposed during her 2016 presidential campaign.

Paul Winfree, an economist at the conservative Heritage Foundation, calculated that the 2019 base level of nondefense discretionary spending surpasses what President Barack Obama sought in his final budget request.

"This is getting comical," Mr. Winfree, who recently left a job as an economic adviser to Mr. Trump, said in a post on Twitter.

While the current pact is only for 2018 and 2019, those who preach fiscal restraint fret that the spending spigot is unlikely to be shut off after that. The Committee for a Responsible Federal Budget projects that the two-year deal would set the stage for $1.7 trillion in additional deficits over the next 10 years because Congress will be operating from a higher budget baseline and will be unlikely to adopt a fresh round of austerity.

"This is the new baseline," said Steve Bell, a senior adviser at the Bipartisan Policy Center and former Republican staff director of the Senate Budget Committee. "With this and the tax cuts, a balanced budget becomes a pipe dream."

Republican lawmakers are re-entering a "deficits don't matter" phase, like the ones that persisted during the Reagan and Bush presidencies. That has conservative economists queasy, as they look at a government budget that is only going to face more stress as an aging population turns to Medicare and Social Security and drives up spending levels.

"Republicans were very concerned about debt and deficits during President Obama's two terms in office. Then their concern kind of evaporated," said Michael R. Strain, an economist at the conservative American Enterprise Institute. "I do think as an economic reality, deficits do matter."

Mr. Strain said the implications of the nation's debt trajectory included significantly higher interest payments, a loss of confidence in American Treasury bonds and less room to maneuver in a recession.

The White House's Office of Management and Budget is expected to release its fiscal 2019 budget next week. Raj Shah, a White House spokesman, said the budget outline would "outline a path toward fiscal responsibility" and that Mr. Trump remained concerned about fiscal discipline.

"He is concerned about spending in Washington," Mr. Shah said. "He's expressed that for years."

Last week the Treasury Department said the United States will need to borrow $441 billion in privately held debt this quarter, the largest sum since 2010, when the economy was emerging from the worst downturn since the Great Depression.

Left-leaning economists are also scratching their heads at the speed at which Republicans seem to be disavowing their commitment fiscal restraint.

"I think it's a little bit surprising and puzzling," said Jason Furman, a former chairman of Mr. Obama's Council of Economic Advisers, noting that trillion-dollar budget deficits is uncharted territory during a period of full employment. "We've never had anything like that outside of a war or a recession."

For their part, Republican leaders who back the budget agreement are focusing on their desire to bolster military spending. They insist they would like to cut spending on programs such as Medicare and Social Security, the biggest drivers of the debt, if the political will were there.

"We're going to work on other entitlement issues this year," Speaker Paul D. Ryan said on the Hugh Hewitt radio show on Thursday. "It's the entitlements that need to be reformed if we're going to deal with the debt."

But Senator Mitch McConnell of Kentucky, the majority leader, has ruled out addressing entitlement programs this year.

To Republicans who oppose the spending bill, the days of Tea Party activists railing against the growing debt seem like ancient history.

"We're living in an unprecedented time from the standpoint of spending, and it's very concerning," said Senator Bob Corker, a Tennessee Republican who considers himself a deficit hawk.

The desire to reduce deficits could return.

A fight between Republicans and Mr. Obama over federal spending and deficits ultimately led to passage of the 2011 Budget Control Act, whose spending caps would be lifted as part of this budget deal.

Mr. Strain, of the American Enterprise Institute, suggested that for deficit reduction to become a prevailing policy for Republicans, another Democratic president might be required.

“We’ve seen that movie before, and I don’t see any reason to think we won’t see it again,” Mr. Strain said.

Thomas Kaplan contributed reporting.

* What’s Hidden in the Senate Spending Bill?

* Trump Signs Budget Deal to Raise Spending and Reopen Government

Senator Mitch McConnell of Kentucky, right, the majority leader, and Senator Chuck Schumer of New York, the minority leader, on Wednesday. The two agreed on a budget package that would blow through spending caps. | Al Drago for The New York Times

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World News: Bank of England Flags Earlier Rate Rise --- Policy makers declare themselves unfazed by market tumult; sterling gets a boost

By Jason Douglas and Paul Hannon
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LONDON -- The Bank of England joined other central banks in warning that recent **financial-market** turmoil won't deter decision makers from tightening monetary policy, saying that stronger-than-expected growth means the bank is likely to raise rates at a swifter pace than it expected to just several months ago.

That message suggests investors are right to believe central banks are pondering more-aggressive action to tame growth in prices amid the first synchronized expansion of the world's biggest economies in a decade.

Concerns that global growth could stoke inflation have fueled sharp swings in stock and bond markets this week. Indeed, the Bank of England's hawkish message came on another day of unsettled and **volatile** trading in Europe and the U.S.

In comments Thursday, Bank of England officials said borrowing costs will need to rise sooner and faster than they expected in November in order to bring inflation back to their 2% goal within two to three years. Annual inflation was 3% in December.

"It will likely be necessary to raise interest rates somewhat earlier and to a somewhat great extent than we had thought," Gov. Mark Carney said at a news conference. He stressed, however, that increases after that would be slow and steady, a message other central bankers have also communicated recently.

Economists said that a rate rise to 0.75% could come as soon as May, with additional quarter-point increases possible later this year and through 2019. The BOE last raised its benchmark interest rate to 0.5% in November. Officials on Thursday held that rate steady at 0.5%.

Central banks around the world have been slowly reeling back very loose monetary policies after more than a decade of ultralow rates and colossal asset-purchase programs aimed at restoring growth and stoking inflation.

Attention has now turned to just how fast that process of normalization will occur. The Federal Reserve is expected to raise short-term interest rates in the U.S. at least three times this year. The European Central Bank may end its massive bond-buying program after completing the latest batch of purchases in September, and investors expect it to begin raising interest rates in 2019.

German Bundesbank President Jens Weidmann on Thursday urged fellow ECB officials not to allow a rising euro or any turbulence in **financial markets** to deter them from winding down their bond-buying program after September.

In his remarks Thursday, Mr. Carney, who also heads the Financial Stability Board, a global club of regulators, added his voice to those of officials at the Fed and the ECB who said the past week's market swings won't push them off course.

He played down the possibility that recent market turmoil reflects weakness in the global expansion. Instead, **volatility** had been unusually low and its return isn't much of a surprise, he said.

"It's certainly healthier when markets have two-way risks around prices," Mr. Carney told reporters.

Sterling immediately rose on the news, climbing as high as $1.402, up more than 1.1%. Against the euro, the pound also rose 1.1% to 1.144 euros. U.K. 10-year gilt yields ticked higher, rising from 1.55% before the announcement to as high as 1.66% after the release.

The BOE said it expects the British economy to grow 1.8% this year and in 2019, reflecting an improved global backdrop. Yet the bank cautioned the U.K. still isn't fully participating in this global upswing due to uncertainties surrounding the terms of the country's exit from the European Union.

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Emerging Markets Weather the Selloff

By Julie Wernau and Georgi Kantchev
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Wild price swings this week upended stocks and bonds around the globe, but some of the historically most **volatile** markets are holding up better-than-expected compared with past global selloffs.

Since U.S. markets reached a high on Jan. 26, the **S&P 500 index** is down 10.2%. Emerging-market stocks performed better during much of the recent selloff. The MSCI Emerging Markets Index is now down 8.6% since Jan. 26.

Bonds issued by companies and countries in the developing world started selling off last week, but by Wednesday the spread between emerging-market debt and U.S. Treasurys -- or the extra yield investors receive for emerging markets -- had narrowed back to levels in late January.

"It's notable how restrained the negative reaction was this time," said Sacha Tihanyi, senior emerging-market strategist at TD Securities in New York.

Unlike during some previous global selloffs, where a government default or currency devaluation in Asia, Eastern Europe or Latin America weighed on global markets, "this time the **volatility** is coming from U.S. markets," said Katia Bouazza, co-head of global banking for Latin America at HSBC. "It's not coming from some headline news in the emerging world."

Investors also point to several positive factors that cushioned the blow. Global growth is on an upswing, a benefit for developing countries that export commodities or are manufacturing hubs.

The International Monetary Fund expects emerging economies as a whole to grow 4.9% in 2018, up from 4.7% last year, and more than double the growth rate in advanced economies. The European Union also said the near-term growth outlook for the developing world has improved, citing buoyant export and service-sector momentum in China and among commodities exporters.

Many emerging-market governments have been building up their foreign-currency reserves, which gives them extra financial flexibility. Stabilizing commodities prices and a weakening dollar, which makes it cheaper for these countries to pay back dollar-denominated debt, have also helped.

"The emerging-markets environment remains positive, and we haven't changed our exposure because of the selloff," said Michael Reynal, chief investment officer of Sophus Capital, part of $55 billion asset manager Victory Capital.

After years of underperformance compared with the developed world, stocks in emerging markets remain cheap versus those in the U.S. or Europe.

Companies in the MSCI emerging-markets **stock index** are trading around 16 times their past 12 months of earnings, as of Wednesday, compared with companies in the MSCI USA index that are trading at about 22 times their 12-month trailing earnings, according to Joe Gubler, portfolio manager at Causeway Emerging Markets Fund.

With many emerging-market shares relatively inexpensive, it was the pricier ones that sold off the most during this week's declines, according to a Goldman Sachs Investment Strategy Group analysis of January valuations.

Two industries in the MSCI Emerging Markets Index -- biotechnology and internet and software services -- were trading at levels that were expensive compared with their historic valuations.

A prolonged slump in U.S. markets may yet take a more serious toll on emerging-market stocks and bonds, analysts say, and the market **volatility** has already been disruptive in pockets.

A bond sale Tuesday by Camposol SA, a Peruvian avocado, blueberry and shrimp farming company, was delayed because of market conditions, investors said. A Camposol official didn't respond to a request to comment.

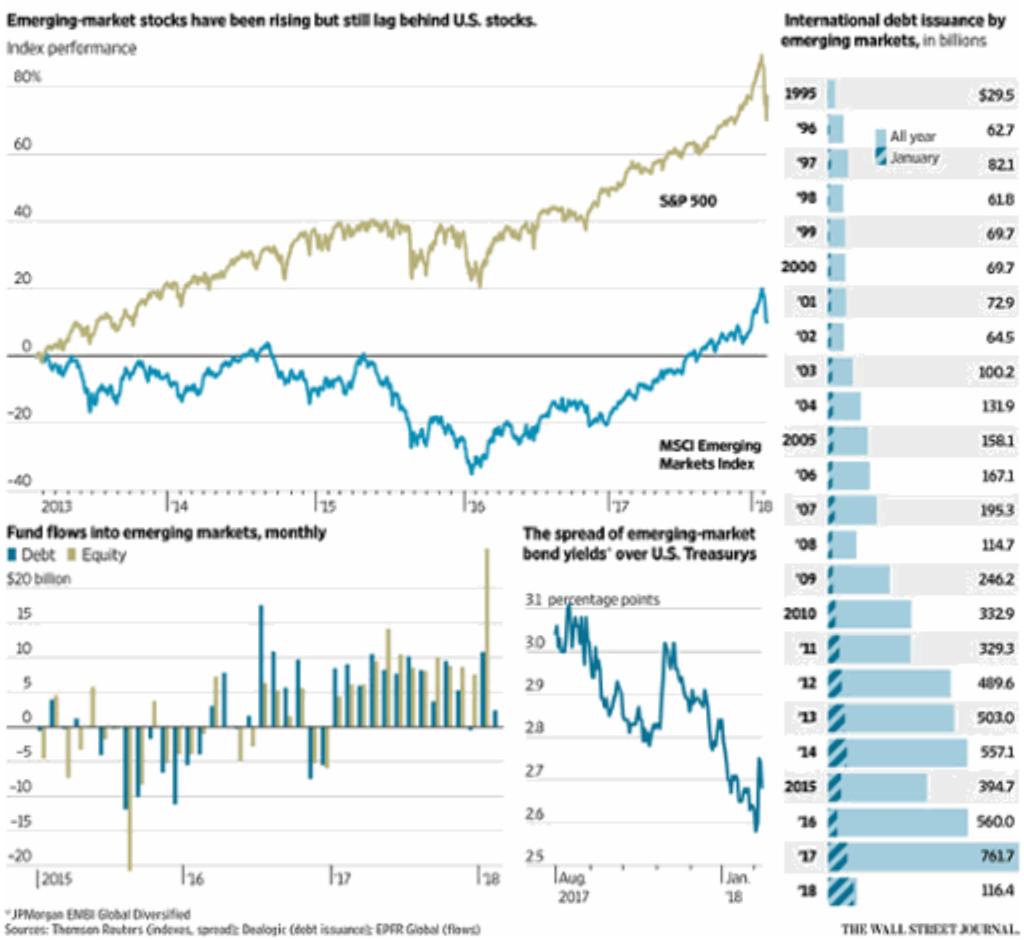
Two bankers said they had encouraged one government issuer and several companies that had started a bond-sales process to hold off pricing until **volatility** subsided. Any sales this week, one of the bankers said, would have had to offer between 0.10 and 0.15 percentage point more in yield than if they were sold before the big market-price swings.

Even without more big jumps in **volatility**, risks remain for emerging-market investors. Bonds from these countries have benefited from investors' global search for yield when interest rates in the developed world are near historic lows.

But if the Federal Reserve responds to recent wage growth or other nascent signs of inflation by raising interest rates more aggressively than expected, that could start to slow the hunt for yield. Higher U.S. rates typically drive investors away from emerging markets by making their bonds, stocks and currencies less attractive.

"The Fed continues to be a concern for the space and there are political risks in places like Mexico and Brazil," said Richard Segal, emerging-market analyst at Manulife Asset Management, which manages $383 billion.

But Mr. Segal said the recent selloff hasn't prompted the fund to change its portfolio. "It was a shock to the system," he said, "but we see it as a temporary blip."



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In Selloff, a Trading Strategy Is Faulted --- Risk-parity funds seen as accelerating rout but managers say selling has been muted

By Corrie Driebusch and Rob Copeland
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The surge in market volatility this week, after a long period of tranquility, left investors seeking a culprit. Critics began pointing to an obscure investment strategy pioneered by the world's largest hedge fund, Bridgewater Associates.

Risk-parity funds aim to reduce the danger from a collapse in any one market by limiting bets on more volatile assets like stocks and commodities and using leverage to load up on safer assets such as government bonds. When volatility jumps, that leverage can in theory force the funds' automated trading strategies to dump those assets, accelerating the selloff.

But some risk-parity strategies outperformed the broader market as the Dow Jones Industrial Average plunged more than 1,800 points over two days and Wall Street's "fear gauge," the VIX, on Monday more than doubled in its largest one-day move in history. Some leading risk-parity fund managers said they haven't traded much during the past several days.

AQR Capital Management LLC co-founder Clifford Asness said his funds were performing as expected even during the frenzy in stock and bond markets.

"We have done pretty much no trading in risk parity" since Friday's stock fall, Mr. Asness said in an interview.

Michael Mendelson, a principal at AQR, added that risk-parity strategies will decline when "everything is down," but that the current shake-up has been too short-lived for there to be meaningful trading by risk-parity managers.

The AQR Risk Parity Fund fell 1.9% on Monday, less than half of the more than 4% decline by the broader stock market. Last Friday, it was down 2%, just under the S&P 500's 2.1% fall.

AQR says it wasn't forced to sell because it already held a smaller equity position than its models called for due to its leverage caps, putting it under less pressure as volatility rose.

AQR is one of the well-known players in risk parity; its AQR Risk Parity Fund has more than $460 million in assets. In total, AQR manages over $30 billion in risk-parity strategies. It is tough to gauge how much risk-parity funds manage in total; estimates range as high as hundreds of billions of dollars.

Bridgewater, for its part, has told clients that in times of market stress its risk-parity funds actually purchase assets that are down, acting as a ballast in a free fall, people close to the firm say. Bridgewater, with $160 billion under management, uses risk-parity trading not just in its dedicated funds but also in its flagship hedge fund, these people say.

Bridgewater co-Chief Investment Officer Bob Prince in an interview described the funds as "so basic . . . the most boring thing, really." He added: "It is definitely not driving global asset prices. It just sits there like a turtle."

The firm's risk-parity operation has made few trades of size in the past week, according to a person familiar with the matter.

Though most traders agree fears of rising inflation sparked the most recent stock-market selloff, market observers were quick to blame various trading strategies as factors that could have exacerbated the declines.

Still, critics say a prolonged period of **volatility** could force risk-parity funds to sell, which could exacerbate declines in the market.

"The biggest issue with risk parity, and all systematic, semipassive strategies, is they all act simultaneously when the market is on autopilot," said hedge-fund manager Katina Stefanova, who bet against these funds with a series of complicated financial instruments that would pay off when market uncertainty rises. Her Marto Capital fund, which manages more than $200 million, is up 4% this year. "If the **stock market** falls, everyone starts selling at the exact same trigger points," she said.

Ira Iosebashvili and James Mackintosh contributed to this article.

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Investors Shed Long-Term Bonds --- Cuts threaten trend of strong demand for corporate debt with lengthier maturities

By Tasos Vossos and Daniel Kruger
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B1
English

Some investors are reducing their exposure to longer-dated corporate bonds as rising yields expose them to a greater risk of losses.

That could help reverse one of the biggest credit trends of recent years: Companies have been selling bonds with longer maturities, and yield-starved investors have been snapping them up.

Investors shedding long-term debt are worried about duration, which measures how sensitive a bond's price is to changes in interest rates. It is higher for longer-term bonds because the greater time it takes for investors to get their money back means greater exposure to swings in value. It also is higher for lower-coupon bonds, which provide less cash flow to buffer those swings.

A rule of thumb is that a 1 percentage-point change in interest rates implies a change in the bond's price equal to the duration. A bond with a duration of 10 years will jump 10% if interest rates fall by 1 percentage point and fall 10% if rates rise by the same amount.

And yields have climbed to multiyear highs in recent weeks. The yield on the benchmark 10-year U.S. Treasury note on Thursday spiked as high as 2.883% in **volatile** trading, according to FactSet, before settling at 2.851% -- near its highest level since January 2014. Several investors and analysts said the gains came after tax cuts and plans for a budget raised concerns that the Treasury would need to borrow more to fund deficits.

Bond auctions this week met with tepid demand, investors said, pushing yields higher still. This month's offerings are the first at the larger sizes the Treasury unveiled last week, and investors are concerned that risks from widening budget deficits will force the government to offer higher yields at future sales to encourage demand. Bond analysts expect the government will need to increase offering sizes again as soon as May and again later in the year.

Spreads between government and corporate bonds have edged higher in recent days, with the rise in sovereign yields weighing on company bonds and investors paring some exposure to riskier debt.

Yields have been rising at a faster pace for corporate bonds with longer maturities.

"Duration is definitely a major risk, and we've been worried about it for quite some time," said Rachid Semaoune, a credit fund manager at Royal London Asset Management, who currently prefers shorter-dated bonds over longer maturities.

The additional risk taken on by holders of corporate bonds in recent years reflects the efforts of central banks to spur faster growth and inflation by lowering borrowing costs, while encouraging investors to take on more risk. Ultralow rates have helped push investors to seek higher returns in corporate bonds, sending the premium company bonds fetch over government debt to decade lows.

Recently, however, central banks have signaled plans to step back from postcrisis stimulus efforts, and investors in the U.S. have become more concerned that higher wages could lead to faster U.S. inflation. That has prompted speculation that the Federal Reserve could speed up the pace of raising interest rates. That has helped to drive down prices on government bonds and push yields higher.

When yields rise, bond investors typically trade into shorter-term securities and out of longer-term debt to minimize the potential for losses. Prices for long-term bonds typically fall more than those for short-term debt, because of the greater potential for the purchasing power of their fixed interest to erode as yields rise.

Christophe Auvity, head of credit at BNP Paribas Asset Management, said he has been positioning the fund's portfolios to favor bonds that are less sensitive to rates and more sensitive to its credit fundamentals, such as cash flows.

Average maturity in the U.S. corporate market has risen to 10.5 years, from 9.6 years in 2013, for bonds listed on the ICE Bank of America Merrill Lynch Corporate index. For euro-denominated credit, it is up to 5.76 from 5.06 years in the same period, and it has risen to 12.5 from 11.6 in the sterling market.

Even in recent weeks, some big European and U.S. companies, including brewer AB InBev and Comcast Corp., have been selling bonds that don't come due for more than 15 years. Last week, Wellcome Trust, a British charitable foundation, sold GBP 750 million ($1.05 billion) of bonds that mature in 100 years.

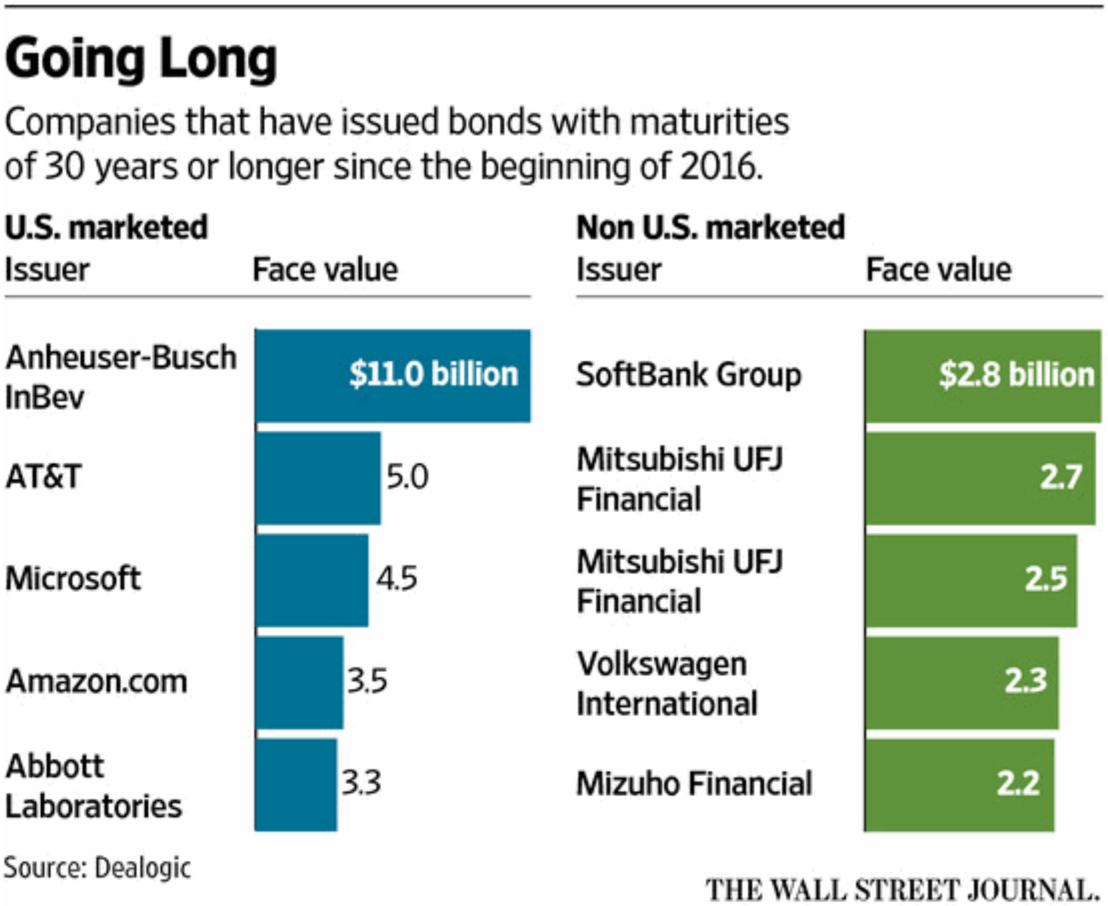
Other companies that have sold long-dated bonds include Amazon.com Inc., which sold $3.5 billion of 30-year bonds in August; Oracle Corp., which sold $2.25 billion of 30-year bonds in November, and Northrop Grumman Corp., which sold $2.25 billion of 30-year bonds in October.

Such longer maturities, coupled with record-low coupons, have left the market more exposed to rises in government-bond yields. Duration in U.S. dollar, euro and sterling investment-grade corporate bonds stands near record highs, according to ICE Bank of America Merrill Lynch indexes. A 1% rise in yields would have triggered a 5.4% drop in U.S. corporate-**bond prices** in that index in late 2008. The same yield increase today would trigger a price drop of more than 7%.

Longer-dated bonds are suffering more.

The price of Microsoft Corp.'s 2057 dollar bonds have fallen 4.1% so far this month. The price of a Microsoft bond that matures in 2023 is down 0.5%, according to data from MarketAxess. The price of Ford Motor Co.'s 2027 dollar bond fell 2.4% in February, while its 2022 note slipped just 0.8%.

Matt Wirz contributed to this article.



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Streetwise: A Historical Tie Breaks, But Trouble Still Lurks

By James Mackintosh
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9 February 2018
The Wall Street Journal
J
B1
English

The relationship between **volatility** and stock prices broke down spectacularly this week, and it is being taken as good news for investors.

There is a strong historical link between the **S&P 500** and the Cboe **Volatility** Index, or VIX. When the VIX goes up, shares go down, by about one-quarter as much. Luckily for shareholders, on Monday that link snapped. Had the S&P fallen in line with the long-term pattern, shares would have plunged about 27% on Monday when the VIX more than doubled in a day for the first time. Instead, the **S&P 500** dropped 4.1%.

On Thursday, the link between stocks and **volatility** was back to something resembling normality, with the VIX climbing 21% and the S&P off 3.8%.

The soaring VIX was in large part down to what investors call technical factors, in this case the implosion of multibillion-dollar structured products that bet on **volatility** staying low. The VIX above 50 spelled doom for stocks in 2008, but this week it was merely about products that were designed to die suddenly meeting their destiny.

The question facing investors is whether they should dismiss the 10% drop in the S&P from its high hit in January as just a temporary technical factor or indicative of deeper troubles ahead.

The basic case is positive. While **S&P 500** implied **volatility** surged to levels only seen after Lehman Brothers failed, other measures of **volatility** stayed calm. Implied **volatility** on U.S. Treasurys and in currency markets rose by far less than would be expected if the VIX was fulfilling its usual function as Wall Street's fear gauge. Similar measures for other stock markets rose much less, too, including in Japan, Europe and on the Russell 2000 index of smaller companies.

It is easy, then, to make the case that Monday's drop was really about some poorly designed structures linked to the S&P. Once investors realized that, panic subsided.

Keith Skeoch, co-chief executive at British fund manager Standard Life Aberdeen PLC, shares the rapidly emerging consensus view: Synchronized global economic growth and still-low interest rates in most of the world continue to supply a solid environment for stocks. Pain for shareholders would come from any disturbance to economic growth or "any evidence that the wage-price spiral is being reignited." He expects neither.

High **volatility** in the past often signaled a short-term buying opportunity, as the subsequent drop would be good for stocks. But if Monday's rise was mostly technical and should be mostly ignored by investors, the same applies to the fall back since.

The fleeting dangers of the VIX may have subsided, but real trouble could still be lurking out there.

There are three concerns. The first is that there could be a lot more selling to come from those who took bets against **volatility** without using products like the VelocityShares Daily Inverse VIX Short Term exchange-traded note, known as XIV.

The XIV and similar structures are now tiny (and dying) and won't be causing any new problems. But pension funds and other long-term investors have piled into strategies that bet against **volatility**, in effect selling insurance against market downturns. The wager is that the insurance premium -- the money from selling options -- makes enough in the good times to cover the sudden nasty losses when the market falls. If investors pull back now, it exacerbates market falls, and there are plenty of other strategies that also buy in up markets and sell in down markets.

For the moment, there don't seem to be major dislocations, and hopefully long-term investors planned for big swings in **volatility**, but it is too early to conclude that there is no more selling to come.

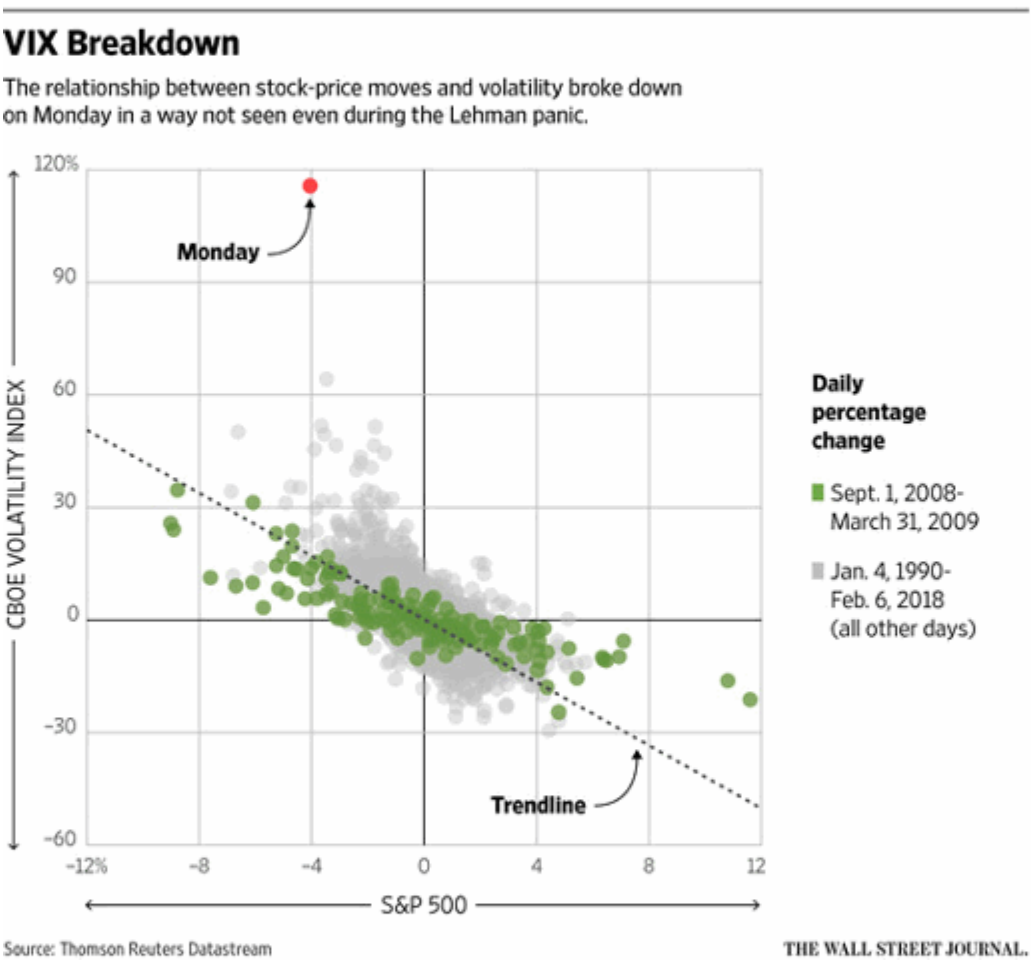
The second worry is that the exchange-traded note was a canary tweeting a message of concern as it died. XIV was designed purely for intraday hedging, and the buyers piling into it for longer periods were a perfect example of complacency. Its prospectus included bold, underlined warnings that its long-term expected value was zero.

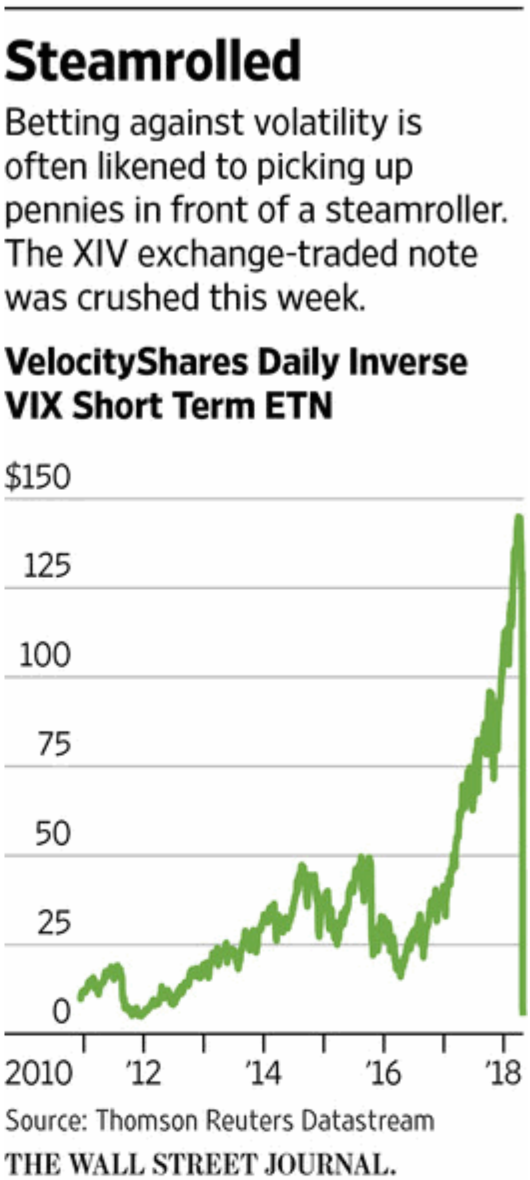
When structured mortgage bets brought down two Bear Stearns hedge funds in 2007, many investors and central bankers also reassured themselves that the wider economy was fine. They were proved catastrophically wrong in 2007, and there are plenty more products with a similar structure to XIV out there, including two-times leveraged long **volatility** products with the same bold, underlined warnings.

But not every complex fund collapse is a sign of deeper trouble ahead. In 1998, the failure of Long-Term Capital Management -- and a string of emerging-market defaults -- proved little hindrance to the expanding **stock-market** bubble. XIV's success was a clear sign of market excess, but its failure isn't necessarily a sign of an imminent crash.

The third concern is that the anxieties that triggered stock declines in the first place remain very much alive. Share-price falls before the VIX spike seem to have been due to rising uncertaintyabout inflation, made worse by the headline wage rises in last Friday's jobs report.

Investors showed themselves to be highly sensitive to the wrong sort of rise in bond yields, and there is no reason to think that has changed. The good news is that lower stock prices create more margin for mistakes.





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The New York Times

Business/Financial Desk; SECT

What Is a Stock Market Correction?

By THE NEW YORK TIMES
238 words
9 February 2018
The New York Times
NYTF
The New York Times on the Web
English

The sell-off in stocks has reached a new level in market lingo: a correction. After tumbling in recent weeks, the **Standard & Poor's 500**-**stockindex** closed on Thursday in that territory.

What is a **stock market** correction?

A correction is a 10 percent drop in stocks from their peak. Since Jan. 26, the **S**.**&P**. **500** has fallen 10.16 percent.

In some ways, 10 percent is an arbitrary threshold. But it often signals that investors have turned more pessimistic about the markets.

Does this mean stocks are headed down even further?

Not necessarily.

Over the past 20 years, there have been 10 corrections in the **S**.**&P**. **500**, including the current one, according to Yardeni Research. The previous correction ended in February 2016.

Of those corrections, only two have turned into bear markets:

Wait. What is a **bear market**?

It is a more severe and usually more sustained downturn in the market, when stocks drop by at least 20 percent.

The last one, during the financial crisis, lasted until March 2009. Then, the **S**.**&P**. **500** sank nearly 57 percent from peak to trough, according to Yardeni Research.

The previous **bear market** occurred during the dot-com bust. From the top of the market in March 2000 until the bottom in October 2002, the **S**.**&P**. **500** lost 49 percent.

Document NYTF000020180209ee290006q

The New York Times

National Desk; SECTA
Another Dive Puts Market in Correction Territory

By MATT PHILLIPS and TIFFANY HSU
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NYTF
Late Edition - Final
1
English

After watching stocks march higher for nearly nine years, investors are suddenly confronting a new reality: The long, smooth ride is over. And it doesn't feel good.

Major stock indexes suffered a steep drop in late trading on Thursday, the second-straight day that stocks dived shortly before the markets closed. The 3.75 percent decline pushed the **Standard & Poor's 500-stockindex** down more than 10 percent from its peak in late January. That means the market is technically in correction territory -- a term used to indicate that a downward trend is more severe than simply a few days of **bearish** trading.

''We've been trained that the market does nothing but go up,'' Bruce McCain, chief investment strategist at Key Private Bank, said of investors. ''And then suddenly, they're anxious, they're sitting nervously on the sidelines, and then they can't take it anymore.''

Trying to pinpoint the exact reasons for the last week's tumble is a fool's errand. But the most likely culprit appears to be fear that central banks will increase interest rates in an effort to fend off inflation and ensure that fast-growing economies don't overheat. Those fears were stoked Thursday when the Bank of England warned that it might raise interest rates faster than investors had expected.

The past week has offered a vivid illustration of how, in a market dominated by fast-moving, computerized trading strategies, things can go from good to bad in the blink of an eye. Last Thursday, markets were on an epic winning streak. But a bad day last Friday was followed by more selling, which begot more and more selling.

In addition to the **S.&P. 500**'s drop on Thursday, the **Dow Jonesindustrial average** fell 4.15 percent. The Chicago Board Options Exchange**Volatility** Index -- a measure of the choppiness of markets -- surged by 21 percent.

The **S.&P. 500** crested at 2,872.87 on Jan. 26. Since then, it has fallen almost 10.2 percent, or 292 points, to close at 2,581 Thursday.

The sell-off continued in Asia on Friday. Shanghai's **stock market** was down about 4 percent midday, while shares in Hong Kong and Tokyo had fallen more than 3 percent. Futures contracts that track stocks in the United States traded erratically, suggesting that the markets on Friday could be in for another day of uncertainty.

The market correction does not mean that the **bull market** in stocks -- which have been roaring since March 2009 -- is over. Markets also experienced a correction in early 2016 before shaking off their jitters and continuing to climb.

Indeed, such ups and downs are routine in most market environments. What makes the past week feel different is that an eerie calm had blanketed markets for the previous year.

Noah Weisberger, a managing director at AB Bernstein, said that over the past few decades, a 10 percent drop would normally happen every 18 months or so.

''It's disquieting, it feels terrible, it's eye-popping when you look at the screen, but it doesn't yet tell you that something is broken,'' he said. ''It's certainly a change in behavior relative to 2017, but then again, 2017 is an anomalous period with incredibly low **volatility** in the market, a very smooth glide-path higher.''

Volatility is back -- with a vengeance. Among the reasons for that is the rise of computer-driven trading, which can accelerate the pace of upward or downward price movements. When algorithms pick up ''sell'' signals, they can instantly shift trading strategies and move billions of dollars.

''That's probably partly why you're seeing these big swings in the market,'' said Steve Massocca, managing director at Wedbush, an investment firm. ''I don't think that's being driven by human hands.''

The long bull market -- stocks were up more than 300 percent at their peak in late January -- has been underpinned, in part, by the extraordinary efforts of the world's central bankers to re-energize growth in the aftermath of the American financial crisis and the deep global recession that followed.

Those efforts helped push interest rates to the lowest levels since World War II, making the safest investments unappetizing and prodding investors toward the stock market.

In the face of broad global growth, some think the central banks will raise interest rates faster than previously expected, eroding a crucial source of confidence that the stock market climb would continue.

Earlier Thursday, the Bank of England said as much, strengthening its forecasts for economic growth and stating that it may have to raise interest rates ''somewhat earlier and to a somewhat greater extent than we thought in November.''

That statement sent up interest rates -- or yields -- on British government bonds, known as gilts.

Yields on Treasuries followed suit, rising as high as 2.88 percent before retreating slightly. The sight of yields on United States government bonds approaching 3 percent seemed to give the markets pause.

Higher government bond yields can make it more expensive for individuals, companies and governments to borrow money. They serve, for example, as the foundation for the interest rates that banks charge on fixed-rate mortgages.

Investors are trying to figure out whether the global economy can keep growing at its current pace if rates rise -- a concern that is contributing to the recent swings in stock prices.

But there's reason to be optimistic about the economy's resilience.

Government data released on Thursday showed that claims for unemployment insurance in the United States remained low, near levels not seen since the early 1970s. That suggests unemployment -- which was 4.1 percent in January -- is likely to remain low in the near future.

Corporate profits also appear solid.

But some of the biggest losers in Thursday's rout were stocks that had done well this year. Canada Goose, for example, which had been up more than 20 percent this year, sank 16.6 percent. Tesla, which had climbed 10.8 percent this year, fell 8.6 percent.

Other hard-hit stocks belonged to companies that could be vulnerable to inflation because rising prices could pinch their profits.

On Thursday, the underwear and sock behemoth Hanesbrands saw its shares tumble nearly 11 percent, making it the worst-performing stock in the S.&P. 500. Early in the day, the company offered a weaker than expected forecast for the year because of rising prices for commodities -- although the company's chief executive noted that Hanesbrands would try to pass on some of those costs to customers.

Even the most successful companies could not dodge Thursday's carnage. Shares of Apple fell 2.75 percent, knocking more than $22 billion off its market value.

Follow Tiffany Hsu on Twitter: @tiffkhsu.

The floor of the New York Stock Exchange on Thursday, when for the second straight day major stock indexes dived in late trading. (PHOTOGRAPH BY BRYAN R. SMITH/AGENCE FRANCE-PRESSE -- GETTY IMAGES) (A20) CHART: Market Corrections: Including the current one, there have been five corrections of the Standard & Poor's 500-stockindex during the bull market that began almost nine years ago. (Sources: Thomson Reuters; Yardeni Research) (CHART BY KARL RUSSELL/THE NEW YORK TIMES) (A20)

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National Desk; SECTA
Shutdown Again Grips Washington as Vote is Foiled

By THOMAS KAPLAN; Sheryl Gay Stolberg contributed reporting.
1,821 words
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English

WASHINGTON -- The Senate early Friday easily approved a far-reaching budget deal that would reopen the federal government and boost spending by hundreds of billions of dollars, but only after enduring a one-man blockade by Senator Rand Paul of Kentucky, who had held up the vote and forced the government to close.

The House is expected to follow before daybreak, though the outcome in that chamber was less certain. If the House approves the deal, the government will reopen before the workday begins.

But Mr. Paul, a Republican, will have made his point. Angered at the huge spending increases at the center of the deal, Mr. Paul delayed passage for hours with a demand to vote on an amendment that would keep in place strict caps on spending that the deal would raise.

''The reason I'm here tonight is to put people on the spot,'' Mr. Paul said on Thursday night. ''I want people to feel uncomfortable. I want them to have to answer people at home who said, 'How come you were against President Obama's deficits and then how come you're for Republican deficits?'''

The shutdown comes on the heels of a three-day closure brought about by Senate Democrats last month. As midnight approached, Mr. Paul did not relent, bemoaning from the Senate floor what he saw as out-of-control government spending and repeatedly rebuffing attempts by his fellow senators to move ahead with a vote.

''I think the country's worth a debate until 3 in the morning, frankly,'' he said.

Senate leaders were left helpless.

''I think it's irresponsible,'' said Senator John Cornyn of Texas, the No. 2 Senate Republican, lamenting what he described as ''the act of a single senator who just is trying to make a point but doesn't really care too much about who he inconveniences.''

Mr. Paul's ideological opponents were not buying his fiscal rectitude either. Senator Brian Schatz, Democrat of Hawaii, posted on Twitter: ''Rand Paul voted for a tax bill that blew a $1.5 trillion hole in the budget. Now he is shutting the government down for three hours because of the debt. The chance to demonstrate fiscal discipline was on the tax vote. Delaying a vote isn't a profile in courage, it's a cleanup.''

Around 1:45 a.m., the Senate finally passed the measure, 71 to 28.

Before Mr. Paul waged his assault on the budget deal, trouble was already brewing in the House, where angry opposition from the Republicans' most ardent conservative members, coupled with Democratic dissenters dismayed that the deal did nothing for young undocumented immigrants, created new tension as the clock ticked toward midnight.

Representative Nancy Pelosi of California, the Democratic leader, told a closed-door meeting of House Democrats that she would oppose the deal, and said Democrats would have leverage if they held together to demand a debate on immigration legislation. But she suggested she would not stand in the way of lawmakers who wanted to vote their conscience.

Pressing the issue further, Ms. Pelosi and the next two highest-ranking House Democrats sent a letter to Speaker Paul D. Ryan of Wisconsin noting their desire for the government to remain open and imploring him to make a public statement about the scheduling of a vote on legislation to protect young immigrants brought illegally to the country as children who are now shielded by the Obama-era Deferred Action for Childhood Arrivals program, or DACA.

"Most of our Members believe the budget agreement is a reasonable compromise to address America's military strength and critical domestic priorities, like fighting the opioid crisis, boosting NIH, moving forward to resolve the pension crisis, caring for our veterans, making college more affordable, and investing in child care for working families," they wrote. "We are writing to again reiterate our request that you make a public statement regarding the scheduling of a vote on a DACA bill."

The struggle to push the bill through the House highlighted the divisions within the Democratic caucus over how hard to push on the issue of immigration as Congress prepares to turn its focus to that politically **volatile** subject.

The text of the deal, stretching more than 600 pages, was released late Wednesday night, revealing provisions large and small that would go far beyond the basic budget numbers. The accord would raise strict spending caps on domestic and military spending in this fiscal year and the next one by about $300 billion in total. It would also lift the federal debt limit until March 2019 and includes almost $90 billion in disaster relief in response to last year's hurricanes and wildfires.

Critically, it would also keep the government funded for another six weeks, giving lawmakers time to put together a long-term spending bill that would stretch through the rest of the fiscal year, which ends Sept. 30. The previous temporary funding measure, which was passed to end the last shutdown, expired at midnight on Thursday.

The deal had been expected to sail through the Senate, and the House had planned to vote on it later Thursday, until Mr. Paul took his stand.

The White House Office of Management and Budget instructed federal agencies to prepare for a possible lapse in funding, a spokeswoman said Thursday night. Even with a technical lapse in government funding, the effect of the shutdown could be minimal if lawmakers can approve the deal before the workday on Friday.

As the midnight deadline approached, Senate leaders from both parties nudged Mr. Paul to stop holding up the vote. And his colleagues had little to do but wait.

"It's just further example of the dysfunction of this place," said Senator Ron Johnson, Republican of Wisconsin. "It's ridiculous, isn't it?"

Senator Johnny Isakson, Republican of Georgia, offered a succinct account of his evening: "Living the dream."

Among the Democratic ranks in the House, the objections were also strenuous, but for reasons very different from Mr. Paul's.

With the monthslong budget impasse appearing to be on the cusp of a resolution, lawmakers were girding for a fight over the fate of young immigrants who were brought to the country illegally as children, known as Dreamers, as well as President Trump's plan to build a wall along the border with Mexico and other possible immigration policy changes.

The uncertain outlook for immigration legislation, and the disagreements on the best strategy to move forward, was starkly apparent as Ms. Pelosi commanded the House floor for more than eight hours on Wednesday in an effort to help the young immigrants. She said she would oppose the budget deal unless Mr. Ryan offered a commitment to hold a vote on legislation in the House that would address the fate of the Dreamers.

On Thursday, Ms. Pelosi herself displayed the conflicting pressures on Democrats. She simultaneously hailed the budget deal while proclaiming she would vote against it. In a letter to colleagues, she explained her opposition to the deal, but also nodded to its virtues and held back from pressuring other Democrats to vote against it.

"I'm pleased with the product," she told reporters. "I'm not pleased with the process."

Mr. Ryan, for his part, stressed his desire to address the fate of the young immigrants. But he did not offer the kind of open-ended commitment that might assuage Ms. Pelosi. Instead, he signaled that whatever bill the House considers would be one that Mr. Trump supports.

"To anyone who doubts my intention to solve this problem and bring up a DACA and immigration reform bill, do not," he told reporters. "We will bring a solution to the floor, one that the president will sign."

The fate of the Dreamers has been in question since Mr. Trump moved in September to end DACA. The president gave Congress six months to come up with a solution to resolve their fate.

In recent months, Democrats have tried to make use of the leverage they have in fiscal negotiations, and the issue of immigration played a central role in last month's shutdown. But Democrats have struggled to determine how hard they should push.

In last month's closure, the vast majority of Senate Democrats voted to block a bill that would have kept the government open, only to retreat a few days later and agree to end the closure after Mr. McConnell promised a Senate debate on immigration.

This time, House Democrats were clearly split in their calculations about the best way to exert influence over immigration.

Representative Luis V. Gutiérrez, Democrat of Illinois, demanded that Ms. Pelosi use her muscle to ''stop the Democrats from folding.''

''Anyone who votes for the Senate budget deal is colluding with this president and this administration to deport Dreamers,'' he said. ''It is as simple as that.''

Democrats also ran the risk of angering liberal activists who want to see them take a stand. Ben Wikler, the Washington director for MoveOn.org, said House Democrats would be making a strategic mistake by voting for the budget deal.

''If you're looking at a boulder and you have a choice between a lever or your bare hands, you should use the lever,'' he said.

But Democrats secured important victories in the budget pact, obtaining big increases in funding for domestic programs. Voting against those wins to take a stand on DACA -- and, now, possibly prolonging the shutdown -- carried its own political risks.

Representative John Yarmuth of Kentucky, the top Democrat on the House Budget Committee, noted that the budget deal ''meets nearly every one of our priorities.''

''If Democrats cannot support this kind of compromise, Congress will never function,'' he said.

The spotlight was on House Democrats in part because it became apparent that Republican leaders most likely lacked the votes to push the budget deal through the House with only votes from their own party.

A sizable number of House Republicans are rebelling against the deal because of its huge increase in spending. The conservative House Freedom Caucus, which has roughly three dozen members, formally opposed the deal.

''It was pretty much a smorgasbord of spending and policy that got added to this,'' said Representative Mark Meadows, Republican of North Carolina and the chairman of the Freedom Caucus. ''Normally, people who eat at smorgasbords all the time are not the healthiest.''

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Senator Rand Paul (PHOTOGRAPH BY ERIN SCHAFF FOR THE NEW YORK TIMES) (A1); Speaker Paul D. Ryan expressed confidence on Thursday morning, as the shutdown deadline neared, that a far-reaching budget deal would be passed by the House. (PHOTOGRAPH BY AL DRAGO FOR THE NEW YORK TIMES) (A17)

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THE WALL STREET JOURNAL.
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U.S. News: Economists Predict Growth Will Pick Up in 2018

By David Harrison and Ben Leubsdorf
395 words
9 February 2018
The Wall Street Journal
J
A4
English

Forecasters see the U.S. economy gathering steam this year and the Federal Reserve raising short-term interest rates three or perhaps four times by the end of 2018.

Economists surveyed in recent days by The Wall Street Journal on average predicted U.S. gross domestic product would rise 2.8% in 2018, accelerating from 2.5% growth in the fourth quarter of 2017 versus a year earlier, supported by the recent package of tax-code changes.

They also projected the unemployment rate would fall below 4% by midyear, from 4.1% in January.

The economists predicted the Fed would raise rates at its next meeting, March 20-21, followed by another move at its June 12-13 meeting.

The central bank in December raised its benchmark federal-funds rate to a range between 1.25% and 1.5%. The economists' average expectation was for the rate to end the year at 2.21%. That is consistent with Fed officials' anticipation of three quarter-percentage-point increases this year, which would lift it to a range between 2% and 2.25%.

The survey respondents' projections have been inching up as their economic forecasts have grown stronger in recent months. In November, they saw the fed-funds rate ending 2018 at 2.07%.

David Berson, chief economist at Nationwide Insurance, said the Fed was "on the borderline between three-four moves this year."

The latest survey of 63 business, financial and academic economists was conducted Feb. 2-6, after the release of the January jobs report and during a period of **stock-market volatility**.

Despite the Wall Street turbulence, the economists remained optimistic about the economy and anticipated the Fed would stick with its plan of gradually raising interest rates under new Chairman Jerome Powell. Some said the chances that officials would move more aggressively than anticipated outweighed the chances they would move less aggressively.

Gus Faucher, chief economist at PNC Financial Services Group, said the Fed under Mr. Powell would maintain "continued gradual tightening."

Nearly two-thirds of forecasters said they saw more risk that the economy would grow faster than it would grow more slowly, another sign of optimism about the outlook.

Michael S. Derby contributed to this article.

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KKR Weighs Shift As Profit Declines

By Miriam Gottfried
372 words
9 February 2018
The Wall Street Journal
J
B10
English

KKR & Co.'s fourth-quarter profit fell as it faced a higher-than-expected provision for income taxes. The firm said it is weighing whether to change its corporate structure on the heels of the new tax law.

For the quarter ended Dec. 31, the New York private-equity firm's earnings fell to $166.4 million, or 32 cents a share from $171 million, or 35 cents a share, in the year-earlier period.

Economic profit, a closely watched performance measure that reflects unrealized investment gains, rose to $414.9 million, or 48 cents a share, from $339.2 million, or 40 cents a share, a year earlier. The result fell short of the 52-cent average per share estimate of analysts polled by FactSet.

Both metrics were hurt by the higher tax provision, which was unrelated to the new tax law passed by Congress late last year. KKR's shares fell 5% on Thursday.

KKR said its senior management and board are "evaluating whether to convert from a partnership to a corporation." The new tax law lowers the corporate tax rate to 21% from 35%, making that structure more attractive. But KKR's peers, including Blackstone Group LP, Apollo Global Management LLC and Carlyle Group LP, have expressed caution during their fourth-quarter earnings calls, citing the potential negative effects a change in corporate structure would have on their profits.

Those negatives could potentially be offset by a higher **stock price**. Shares of publicly traded private-equity firms aren't included in indexes because of their partnership structure. Becoming "C corporations" would make it easier for many investors to own their shares, lifting demand.

Had the new tax law been in place at the beginning of 2017, KKR's reported after-tax economic net income would have been about 17% lower if it were structured as a traditional corporation, the firm said on a conference call Thursday. To make up that difference, the price/earnings multiple at which KKR's stock trades would need to expand to 11 times from the 9.3 times it stood at as of Wednesday's close, it said.

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Airbnb Income to Count for Refinance Loans

By Laura Kusisto
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9 February 2018
The Wall Street Journal
J
B10
English

Homeowners soon will be able to count income they earn from Airbnb Inc. rentals on applications for mortgage refinancings.

A new program announced Thursday by Airbnb, mortgage giant Fannie Mae and three big lenders will allow anyone who has rented out property on Airbnb for a year or longer to count at least some of that money as income.

Refinancing can be a way for a homeowner to tap home equity for renovations, college tuition or other big expenses, or to reduce their monthly payments.

Lenders have been tougher on income from side businesses and part-time work since the mid-2000s, when poorly documented income claims on mortgage applications helped fuel the housing bubble.

Airbnb, which launched in 2008, argues that its service includes reliable technology to track income, and that it is helping middle-class Americans stay in their homes by giving them a way to generate additional cash.

"The whole big idea behind Airbnb . . . was how could people unleash or capture the value of the home that they were in. Typically it's the greatest expense for any family," said Chris Lehane, head of global policy and public affairs for Airbnb. "I do think this announcement is a next chapter in that process."

The mortgages under the program will be backed by Fannie Mae, an acknowledgment that Americans today increasingly are earning money through the "gig economy," such as renting out rooms or ride-sharing.

Initially, three lenders, Quicken Loans Inc., Citizens Financial Group Inc. and Better Mortgage Inc., will participate in the program. Fannie will evaluate the initiative and could decide over time to back mortgages from any lender that chooses to count Airbnb income in a refinancing, as long as the short-term rentals aren't against local laws.

"Rental income on your own home is something that 10 years ago we almost never saw," said Jonathan Lawless, vice president of customer solutions at Fannie Mae. "The fact is that we're seeing this much more commonly across the country."

Still, the move raises worries about encouraging homeowners to borrow more based on the unpredictable tourism industry.

"I think it's a concern in terms of **volatility**, but I also think you don't want to say absolutely not because it's the future of work," said Dan Immergluck, a professor at the Urban Studies Institute at Georgia State University, who studies the housing market, mortgage finance and foreclosures.

Airbnb has faced a host of regulatory challenges around the country. It has encountered stiff push-back from tenant advocates, for example, who argue it is exacerbating the housing shortage and driving up rents.

So far most of the scrutiny has focused on rental apartments and homes that are converted to full-time vacation rentals, with regulators generally tolerating homeowners renting out a primary residence.

There is a risk that could change. "If you're in a place where it's booming, but a year from now they're going to clamp down on it," that could jeopardize income generated from Airbnb, Mr. Immergluck said.

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Treasury Auctions

136 words
9 February 2018
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The Treasury Department will auction $97 billion in securities next week. Details (all with minimum denominations of $100):

-- Monday: $48 billion in 13-week bills, a reopening of an issue first sold on Nov. 16, 2017, maturing May 17, 2018. Cusip number: T912796PG8.

Also, $42 billion in 26-week bills, a reopening of an issue first sold on Aug. 17, 2017, maturing Aug. 16, 2018. Cusip number: 912796NQ8.

Noncompetitive tenders for both issues must be received by 11 a.m. EST Monday and competitive tenders by 11:30 a.m.

-- Thursday: $7 billion in **30**-**year Treasury** inflation-protected securities, dated Feb. 28, 2018, and maturing Feb. 15, 2048. Cusip number: 912810SB5. Noncompetitive tenders must be received by noon Thursday; competitive tenders, by 1 p.m.

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THE WALL STREET JOURNAL.
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Heard on the Street
Overheard

165 words
9 February 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

If they weren't state workers with the sort of job protection lacking in the private sector, the people who process unemployment claims might be lining up at the unemployment offices.

Initial jobless claims reported Thursday morning were 221,000 for the previous week, about 11,000 fewer than expected.

That series is **volatile**, but the smoother four-week average is now down to 225,000, which is the lowest figure since 1973. Considering the fact that the U.S. population was one-third lower back then, that comparison is remarkable.

One reason for the difference is that these days fewer people work in factory jobs subject to periodic furloughs and more work in interchangeable service jobs like pouring coffee at Starbucks. Another is that the U.S. labor market really is very tight.

Should the unemployment people ever become unemployed, we hear there are lots of openings for baristas.

page,5043
Document J000000020180209ee290000l

The New York Times

Business Day; Economy
We All Have a Stake in the Stock Market, Right? Guess Again

By Patricia Cohen
1,090 words
8 February 2018
03:48 PM
NYTimes.com Feed
NYTFEED
English

Take a deep breath and relax.

The riotous market swings that have whipped up frothy peaks of anxiety over the last week — bringing the major indexes down more than 10 percent from their high — have virtually no impact on the income or wealth of most families. The reason: They own little or no stock.

A whopping 84 percent of all stocks owned by Americans belong to the wealthiest 10 percent of households. And that includes everyone's stakes in pension plans, 401(k)'s and individual retirement accounts, as well as trust funds, mutual funds and college savings programs like 529 plans.

"For the vast majority of Americans, fluctuations in the **stock market** have relatively little effect on their wealth, or well-being, for that matter," said Edward N. Wolff, an economist at New York University who recently published new research on the topic.

Both Republicans and Democrats have promoted the idea that a rising **stock market** broadly lifts Americans' fortunes. When there was a parade of market rallies, President Trump asked, "How's your 401(k) doing?"

There was a move toward democratizing stock ownership in the 1980s and 1990s, with the advent of individual retirement accounts, but the busts of 2001 and 2007 scared off some middle-class investors.

Of course, any financial loss can be scary and painful. Indeed, the less you have, the more each dollar counts. And market gyrations could foreshadow deeper problems that signal the end of a nine-year boom and short-circuit the economic recovery.

But the day-to-day impact on most people's overall wealth is minimal.

"It's far from where you think that it would be, given the rhetoric," said Ray Boshara, director of the Center for Household Financial Stability at the Federal Reserve Bank of St. Louis.

A look at some fundamentals may provide a clearer perspective.

Stock ownership is the exception.

Roughly half of all households don't have a cent invested in stocks, whether through a 401(k) account or shares in General Electric. That leaves half the population with some exposure to **financial market** whims, but as Mr. Boshara said, "some exposure can be 100 bucks."

"If you look at where the money is really held, it's among the top 10 percent," he said. "And if you break it down by age, race and education and parental education, you'll see the disparities are even larger." Parents who lack a four-year degree and, later on, their children are much less likely to have a direct stake in the **stock market** than college graduates; blacks and Hispanics are much less likely than whites.

"It's too bad such a small percentage of the population has any real or meaningful ownership stake in equities, given their historic and current growth," Mr. Boshara said.

Most households had less than $5,000 in total holdings in 2016, the most recent year analyzed by Mr. Wolff. Despite the slow recovery in housing prices, the wealth of middle-class Americans is still concentrated in their homes, which remain their single most valuable asset.

For 9 out of 10 households, even a shift in value of 10 percent — enough to qualify as a "market correction" — would "at most, have a 1 or 2 percent impact on their wealth holdings," Mr. Wolff said.

If anything, foreign multinational and other investors would feel more of a pinch, since they own 35 percent of all United States corporate stock, up from 10 percent in 1982. That share of the pie exceeds the single slice owned by taxable American shareholders, defined benefit plans, defined contribution plans, or nonprofit institutions, said Steven M. Rosenthal, a senior fellow at the nonpartisan Urban-Brookings Tax Policy Center.

Don't confuse the Dow with the economy.

The **stock market** and the underlying economy are distinct. The two interact, but they do not proceed in lock step or even respond to each other in predictable ways. Certainly, market instability can undermine both consumer and business confidence and restrain spending and investment. And market bubbles, swelled by overextended borrowing, can explode, wreaking losses and stalling growth.

Still, valuations of assets and the country's economic health — as determined by productivity, employment, investment, spending, housing values, production capacity, growth and more — are two different kettles.

"If all that happens is the **stock market** decreases or increases in value, but no real fundamentals change," C. Eugene Steuerle, an economist at the Urban Institute who served in the Reagan administration, said, "then there are actually a lot of winners, not just losers."

"Older people can buy less stock," and fewer goods and services, because they are living off their investments rather than accumulating them, Mr. Steuerle said. But younger people can better afford to buy stock while it is cheap, which sets them up for bigger gains down the road.

"Attention, discount shoppers," Michelle Singletary, a personal financial columnist for The Washington Post, advised on Thursday. "The recent **stock market** dive is like a holiday weekend sale."

The economy still seems solid.

When it comes to evaluating the economy's fundamentals, assessments come in a Revlon rack of shades. Economists warn that mounting debt, as a result of the costly $1.5 trillion tax package, threatens economic stability over the longer run, as private investment is crowded out and interest payments balloon. Productivity growth is anemic and labor participation rates are low by historical standards.

Still, the signs of strength — at least for the next couple of years — are impressive.

Unemployment is near record lows, total output is rising at a faster rate, bond yields are up, **oil prices** have increased, and consumer and business confidence remain high. Every major economy around the world is growing in concert, simultaneously propelling and reinforcing a positive cycle.

After all, one of those indicators — a January jobs report that showed healthy payroll expansion and a jump in yearly wage growth — is what helped set off the **stock market** tumult last Friday.

Follow Patricia Cohen on Twitter: @PatcohenNYT.

* For Millennial Investors, a Harsh Lesson in Market Gyrations

* Trump Laments the **Stock Market** Plunge as a 'Big Mistake'

* So It's Your First Market Hiccup. What Should You Do Now?

* Context Matters. The **Stock Market** Drop Is Less Scary Than It Seems.

Wall Street's **volatility** is merely a spectator event for most Americans, whose wealth is not held in stocks. | Sam Hodgson for The New York Times

Document NYTFEED020180208ee28007y5

Opinion
Opinion
What Bitcoin Reveals About Financial Markets

By John Quiggin
890 words
8 February 2018
03:26 PM
NYTimes.com Feed
NYTFEED
English

The spectacular increase and recent plunge in the price of Bitcoin and other cryptocurrencies have raised concerns that the bursting of the Bitcoin bubble will cause financial markets to crash. They probably won't, but the Bitcoin bubble should finally destroy our faith in the efficiency of markets.

Since the 1970s, economic policy has been based on the idea that financial market prices reflect all the information relevant to the value of any asset. If this is true, market prices are the best estimates of the value of any investment and financial markets should be relied on to allocate capital investment.

This idea, referred to in the jargon of economics as the efficient market hypothesis (technically, the strong efficient market hypothesis), implicitly underlay the deregulation of financial markets that started in the 1970s. Although rarely stated now with as much confidence as it was during its heyday in the 1990s, the efficient market hypothesis remains a background assumption of much central-bank and economic policy.

The hypothesis survived the absurdities of the dot-com bubble in the late 1990s and early 2000s, as well as the meltdown in derivative markets that led to the global financial crisis in 2007 and 2008. Although the hypothesis should have been refuted by those disasters, it lived on, if only in zombie form.

But at least each of those earlier bubbles began with a plausible premise. The rise of the internet has transformed our lives and given rise to some very profitable companies, such as Amazon and Google. Even though it was obvious that most 1990s dot-coms would fail, it was easy to make a case for any of them individually.

As for the derivative assets that gave us the global financial crisis, they were viewed favorably in light of a widely held theory, known as the "great moderation," that suggested that major economic crises were a thing of the past, thanks to certain systemic changes in the way developed nations ran their economies. The theory was backed by leading economists and central bankers. Asset-backed derivatives were, ultimately, a bet on the great moderation.

The contrast with Bitcoin is stark. The Bitcoin bubble rests on no plausible premise. When Bitcoin was created about a decade ago, the underlying idea was that it would displace existing currencies for transactions of all kinds. But by the time the Bitcoin bubble took off last year, it was obvious that this would not happen. Only a handful of legitimate merchants ever accepted Bitcoin. And as the Bitcoin bubble drove up transactions charges and waiting times, even this handful walked away.

For a while, Bitcoin was used for transactions that people wanted to keep secret from government authorities, like drug deals. It soon became apparent, however, that if authorities wanted to track these transactions, they could. For instance, Silk Road, the first major online drug market, which made use of Bitcoin, was shut down by the F.B.I. in 2013.

Hardly anyone now suggests that Bitcoin has value as a currency. Rather, the new claim is that Bitcoin is a "store of value" and that its price reflects its inherent scarcity. (By design, no more than 21 million Bitcoins can be created.)

Most economists, including me, dismiss this claim. And if the claim is false, Bitcoin's value is obviously another deadly strike against the efficient market hypothesis.

But even if the claim is true, the idea that Bitcoin is valuable simply because people value it and because it is scarce should shake any remaining faith in the efficient market hypothesis.

Consider: If Bitcoin is a “store of value,” then asset prices are entirely arbitrary. As the proliferation of cryptocurrencies has shown, nothing is easier than creating a scarce asset. The same argument would apply to any existing financial assets. Any stock in the **S & P 500** could be priced not in terms of future earnings prospects but on the basis that people choose to value it highly.

Suppose, more plausibly, that Bitcoin has no underlying value and will eventually become worthless. According to the efficient market hypothesis, **financial markets** will correctly estimate the true value of Bitcoin and will drive the price to zero immediately.

But that hasn’t happened either. Until recently, it wasn’t even possible because the Bitcoin markets were themselves as opaque as the currency.

Now it is possible: Futures trading for Bitcoin on the Chicago Mercantile Exchange has been going on since December. But Bitcoin prices rose after the creation of futures trading and began their sharp decline only when governments took measures to limit speculation.

Current futures contracts in Bitcoin extend as far as June of this year. According to those contract prices, the market expects Bitcoin to retain its value well into the future.

Whatever happens to Bitcoin, we must not lose sight of a more fundamental — and more worrisome — development: A financial product with a purely arbitrary value has been successfully introduced in the world’s most sophisticated **financial markets**.

Bitcoin probably won’t bring **financial markets** crashing down. But it shows that regulators need to cut those markets down to size.

John Quiggin is an economist at the University of Queensland in Australia and the author of “Zombie Economics: How Dead Ideas Still Walk Among Us.”

Document NYTFEED020180208ee28007k9

THE WALL STREET JOURNAL.
U.S. EDITION

Analysis: Market Swings Aren't the Problem

By Greg Ip
833 words
8 February 2018
The Wall Street Journal
J
A1
English

Don't worry about **stock-market volatility**: It is perfectly normal. Do worry about how stocks got so high to start with because it is evidence of an economy still abnormally dependent on low interest rates andrichly priced assets.

The 2,271-point drop in the **Dow Jones Industrial Average** in the week through Monday, a decline of 9%, didn't even meet the usual 10% threshold for a correction. Tuesday's 567-point rebound didn't make the top-500 daily increases by percentage. Wednesday's 509-point swing between high and low was positively humdrum, with the Dow closing down 19 points, or 0.1%, at 24893.

Even more reassuring, the **volatility** is being driven by the most banal of reasons: worries about inflation and interest rates.

An inflation scare is an entirely different animal from the deflation scares that have rocked markets in the past decade, including the U.S. financial crisis of 2008, Europe's government-debt crisis of 2011 and China's slowdown in 2015. Each of those events tanked, or threatened to tank, a key economy and push inflation into negative territory. In each, investors bet on more central-bank measures to prop up growth.

This time it isn't slow growth, deflation or more central-bank stimulus that preoccupies investors, but the opposite. Last Wednesday, the Federal Reserve released a statement in which it predicted "further" gradual interest-rate increases. The word "further," which wasn't in December's statement, subtly signaled more conviction that higher rates are in order. Then Friday's report on January job growth was accompanied by the largest annual increase in wages since 2009.

During deflation scares, investors sought safety in government bonds, driving their prices up and yields down. Now U.S. bond yields are rising, standing near a four-year high as of Tuesday.

Inflation results from the economy pressing up against its productive capacity. That is a fundamentally **bullish** development. Higher wages and profit estimates aren't the precursors of a recession or a prolonged **bear market**.

True, if inflation sustainably pierced the Fed's 2% target, that would usher in much higher interest rates, and probably recession.

But why wring one's hands over the prospect when inflation, excluding the **volatile** food and energy categories, has been stuck below 2% for five years and hasn't hit 3% in a quarter-century?

Yet if the **stock-market** downdraft isn't worth fretting over, the same can't be said about the backdrop in which it happened, starting with that quiescent inflation picture. It has taken nine years and the lowest unemployment since 2000 to produce even a modest uptick in wages (and even that may prove fleeting). That shows how an aging population and lackluster productivity represent powerful and persistent headwinds to long-run growth, even if U.S. tax cuts have raised the short-run outlook.

Treasury yields are still below 3%, and below 1% when adjusted for inflation. Overseas, they are even lower. This is the consequence of a fundamentally pessimistic long-term growth outlook and of global central-bank efforts to prop up growth with low interest rates and trillions of dollars of bond purchases.

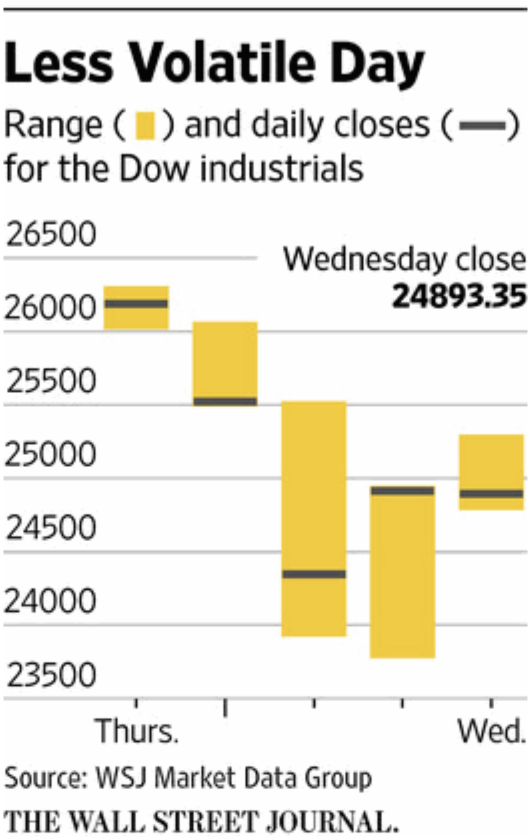
It is good news that such extreme measures are no longer needed. The Fed began raising rates in late 2015 and winding down its bondholdings last year; both the European Central Bank and Bank of Japanare moving to slacken the pace of bond buying.

But nearly a decade of ultra-easy monetary policy has sent asset prices sky-high and kept **volatility** unnaturally low. Even with the latest downdraft, U.S. stock values at Monday's close equaled 152% of gross domestic product, compared with 127% at the precrisis peak.

The borrowing excesses that precipitated the financial crisis of 2008 are largely absent today, yet a hunger for risk still permeates markets from bitcoin to junk bonds to real estate in Toronto and Sydney.

Even before he became Fed chairman this past Monday, Jerome Powell had observed how recent expansions ended not with inflation but collapsing asset bubbles. And they don't need to bring on a financial crisis to do damage. Goldman Sachs estimates that higher stock prices added 0.6 percentage point to U.S. growth last year via the wealth effect -- households spending their stock winnings. By Goldman's calculation, a 20% hit to prices this year could knock 1.1 points off growth. That would more than wipe out the stimulative effect of the tax cut.

There is no reason to assume this latest pullback is the start of a deflating bubble; stocks are richly valued but conceivably make sense given optimistic assumptions about growth, interest rates and **volatility**. But asset markets routinely overshoot their fundamentals, and that is a worry that will hang over the economy so long as interest rates and inflation remain abnormally low.



Not Normal

Even with the latest market selloff, stock values are historically high, while inflation and interest rates are historically low.

*Price index of personal consumption expenditures excluding food and energy
Source: Market Data Group; Commerce Department; Federal Reserve Bank of St. Louis

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
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Heard on the Street
Don't Count on Fed Safety Net for Stocks

By Justin Lahart
580 words
8 February 2018
The Wall Street Journal
J
B1
English

[Financial Analysis and Commentary]

Investors think the Federal Reserve is waiting with a net below the **stock market**, and chances are they are right. The only problem is that the net is far below where stocks are now.

The recent sharp drop in stocks began because investors were worried the Fed might raise rates faster than they had thought. When the selloff got worse, there was a view that the Fed might not raise very much because of the **volatile** market. Interest-rate futures now suggest investors are split over wheth-er the central bank will raise rates three times this year, as Fed policy makers have projected, or just twice. Contrast that with early Friday, when the futures started pricing in the possibility of a fourth rate increase.

With the economy strong and the market still expensive, investors shouldn't expect a Fed rescue if shares tumble. Tuesday's powerful market rebound makes it even less likely.

The idea that the Fed will help stop a selloff has been part of the market's dynamics for years. In early 2000, former Merrill Lynch derivatives strategist Steve Kim and former Pimco fund manager Paul McCulley started calling the Fed's tendency to cut rates or hold off on rate increases in response to **financial market** turmoil "the Greenspan put" after then-Fed Chairman Alan Greenspan. The phenomenon was most recently on view in early 2016 when the Fed dialed back its rate-increase plans in response to a global market selloff. Now, it is known as the Fed put.

Recent research from Duke University economist Anna Cieslak and University of California, Berkeley, economist Annette Vissing-Jorgensen shows the Fed put is very real. They found that stock returns are a more powerful predictor of changes in the Fed's interest-rate target than any one of 38 economic data points ranging from job growth to consumer spending to inflation. But the Fed's rate response is also asymmetrical: It responds significantly to negative stock returns, but not positive ones.

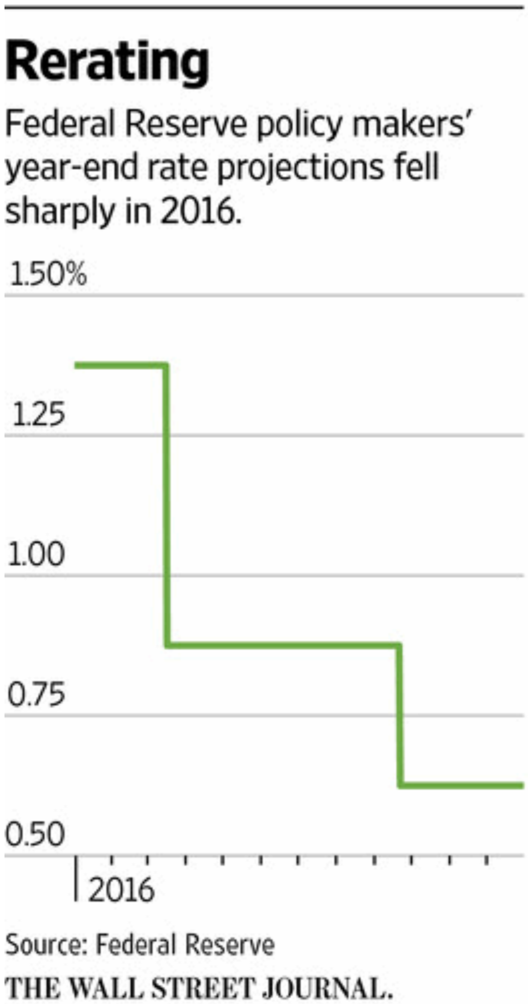
The economists then conducted a textual analysis of Fed minutes and transcripts to figure out why it was reacting to the **stock market**. Their finding: Fed policy makers worry that falling stocks might lead to cuts in consumer spending and hurt companies' ability to raise money, potentially slowing the economy. They don't look at the market as an indicator of where the economy is going.

If those are the criteria, it is hard to imagine the Fed is particularly worried.

Even if stocks fall a whole lot more, the Fed might not be so quick to respond. The thicket of financial concerns and fragile global economic conditions that led them to postpone raising rates in 2016 aren't there.

Moreover, stock valuations remain rich, and the Fed seems worried that investors have taken on excessive risk. That may be particularly true of newly installed Fed Chairman Jerome Powell, who during the lead-up to the 2013 taper tantrum was part of a group of Fed policy makers sharing financial-stability concerns.

Nor does Mr. Powell likely want to set the tone for his tenure at the Fed by canceling rate increases in order to save stock investors from themselves. Falling stocks probably would have to pose a real threat to the economy before the Powell put is sprung.



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Document J000000020180208ee280001q

THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: VIX Concerns Hurt Cboe

By Ben Eisen
496 words
8 February 2018
The Wall Street Journal
J
B10
English

Investors are turning cautious on the exchange company behind **volatility** trading, an example of fallout from the recent **stock-market** rout.

Shares of Cboe Global Markets slid 12% on Tuesday, marking their worst daily performance since the company went public in 2010. The stock was down a further 2% to $114.57 Wednesday as investors grappled with tumult in the market for futures on the Cboe **Volatility** Index, or VIX, one of the company's rapidly growing products.

Analysts expressed concern that demand for VIX futures could drop after a blowup in some popular products that use them to bet on falling **volatility** in the **stock market**. Credit Suisse Group AG said Tuesday that it was effectively shutting down an inverse **volatility** exchange-traded product due to large losses.

"Given VIX has been a key growth driver of CBOE, we also see the potential for a deterioration in CBOE valuation," said JPMorgan Chase & Co. analysts, led by Kenneth Worthington, in a note to clients Wednesday. The firm dropped its rating on the stock to "neutral" from "overweight." It also lowered the price target to $110 from $131.

Cboe said the VIX futures market behaved as it was meant to through this week's market swings. Short **volatility** trading, "has been around since options and derivatives were listed and will continue to be an active strategy," said Edward Tilly, chief executive of Cboe, in a conference call with analysts Wednesday. The company is due to report earnings Friday.

Brian Schell, Cboe's deputy chief financial officer, said on an earnings call in November that the company's strong organic growth in the July-to-September period was, "primarily due to our proprietary products, particularly VIX futures and VIX options."

Exchange-traded products that utilize VIX futures are just a small portion of the investment strategies that wager on **volatility**, according to JPMorgan. Betting on **volatility** to drop has been especially profitable for investors, including pension and sovereign-wealth funds, as the VIX hit record lows last year. It was also a boost to Cboe.

In January, those betting on a drop in **volatility** made up more than one-third of open interest in VIX futures, according to Jefferies estimates. But as **volatility** picked up, those trades were tested, and could continue to face challenges, analysts say.

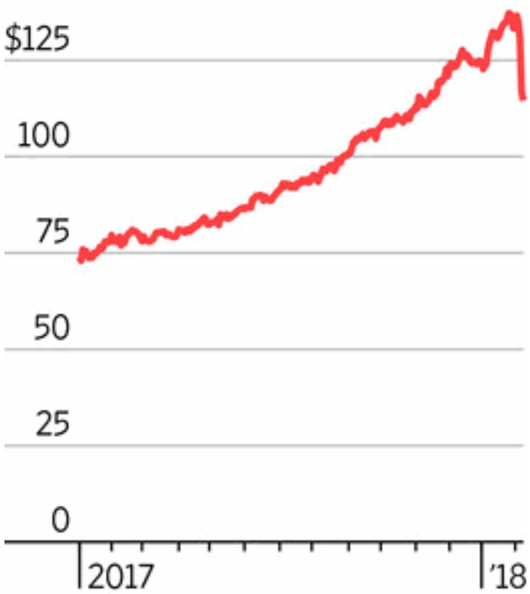
"We think if these strategies are under material pressure, CBOE VIX Futures and VIX options activity could be under pressure too," the JPMorgan analysts wrote.

Jefferies analysts, led by Daniel Fannon, estimate that VIX futures make up roughly 13% of Cboe's net revenue. That is after VIX futures doubled as a share of transaction volumes over the past five years to about 20% in 2017. They noted that Cboe has built a diversified business, especially after its merger with stock-exchange operator Bats Global Markets last year.

Alexander Osipovich contributed to this article.

Follow the Futures

Cboe Global Markets shares took a dive this week as the market rout unfolded.



Source: WSJ Market Data Group

THE WALL STREET JOURNAL.

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The New York Times

Business/Financial Desk; SECTB
Is the Economy at Risk of Overheating? With Inflation, It's Tricky

By NEIL IRWIN
1,867 words
8 February 2018
The New York Times
NYTF
Late Edition - Final
3
English

To the degree the recent wild swings in the **stock market** are rooted in economic fundamentals, these are the fundamentals to fear: that the already strong economy may overheat, inflation may spike, and the Federal Reserve may then raise interest rates more aggressively to try to combat that higher inflation.

The kernel of evidence that supported those fears was a report Friday that average hourly earnings for American workers rose 2.9 percent over the 12 months ended in January, the highest since the economic expansion began nine years ago.

It's only a single data point, and an erratic one at that. But when paired with a rock-bottom unemployment rate and some signs of acceleration in economic growth, it suggests that overheating/inflation is a meaningful risk for the United States economy in 2018 in a way it hasn't been for a decade.

What does it all mean and how real is the risk? To answer the question, it helps to start with some basics.

What is inflation?

Inflation is when the buying power of a currency falls over time. When inflation is 2 percent, a basket of products that cost $100 today would cost $102 a year from now.

But people buy lots of different things, some prices are always rising and others falling, and the exact mix of items I buy is different from the mix of items you buy.

That's why government statisticians and mainstream economists focus on indexes created to try to capture the full range of goods and services people consume, weighted by how much an average household spends on each.

Plenty of people may have their own preferred way of measuring inflation; in recent years a profusion of commentators has emphasized declines of the dollar relative to other world currencies, or to gold, as definitive evidence. But the advantage of broad indexes is they approximate, if imperfectly, how much prices are changing for the range of things ordinary people buy.

Is inflation good or bad?

It's both.

High inflation can be disastrous. In Venezuela right now, in Zimbabwe a few years ago, in Weimar Germany in the early 1920s, inflation was so extraordinarily high that the currency essentially ceased to be a useful medium of exchange, leading to a barter economy and breakdown of the country's financial system.

Even milder versions of high inflation, such as the inflation that topped out at more than 14 percent in the United States in 1980, is damaging. At that level, those who have accumulated savings or fixed pensions see their purchasing power vanish over time, and borrowing costs skyrocket (ask anyone who took out a home loan in the early 1980s what their mortgage rate was). That dynamic can impede growth and create broad unhappiness. The economist Arthur Okun even invented the "misery index" in the 1960s, calculated by adding up the unemployment rate and inflation rate.

But when inflation turns negative -- that would be deflation, meaning the purchasing power of a currency rises over time -- it can also be disastrous. Debts become more onerous over time, and consumers and businesses have incentive to hoard cash rather than spend or invest it.

That's what the United States and other countries experienced during the Great Depression, and it has been experienced in milder forms by Japan over much of the last 20 years and Europe since 2010.

So how much inflation do we want?

It might seem inherently bad to have the purchasing power of a falling dollar. But having a bit of inflation seems to grease the wheels of the economy while not distorting economic decisions too much. It helps cushion against deflation, and gives the Fed room to cut interest rates and stimulate the economy during a downturn, helping keep the economy on an even footing.

Over the last couple of decades, central bankers around the world have mostly settled on 2 percent per year as the optimal level of inflation that they aim for. It's a level low enough that the purchasing power of their currencies is fairly stable and people don't have to worry about inflation all that much in doing business with one another, while also keeping a buffer to prevent deflationary effects from taking hold.

That said, 2 percent is a fairly arbitrary number, and some economists argue that steady inflation at a somewhat higher level would help prevent recessions.

The important thing is arguably less the exact level of inflation and more that it is fairly stable over time. It is big swings that tend to be most disruptive, favoring either debtors (inflation) or creditors (deflation), and generally contributing to lack of faith in a country's financial system.

For now, though, 2 percent is the goal.

How much inflation are we getting?

Under the inflation measure that the Federal Reserve most focuses on, prices rose only 1.5 percent in 2017, below the target. That's based on the personal consumption expenditures price index, excluding food and energy (the logic being that commodity prices can swing wildly for reasons unrelated to underlying inflation trends).

That's not far from the 2 percent target. But the numbers have been undershooting that target continuously since 2012. That undershooting has been a key rationale for the Fed's keeping interest rates low -- its aim is to boost economic growth and thus help get inflation up to the 2 percent target.

Wait, what does inflation have to do with economic growth?

The answer is more uncertain than you might think. A central component of the models that mainstream economists have used for decades is that the inflation rate is shaped by the amount of ''slack'' or unused capacity in the economy, especially unemployment.

The intuition goes like this: When the unemployment rate is high, there are lots of workers available for any employer that wants to hire them. So employers don't need to compete for workers by paying higher prices. But if the unemployment rate is low, companies have to pay more to get employees, driving up wages. Higher wages in turn mean more money coursing through the economy chasing finite goods and services, creating inflation.

That basic relationship between unemployment and inflation is known as the Phillips Curve. It did a pretty good job explaining inflation trends from the 1950s to the 1980s, and still forms the underpinnings of how many policymakers think about where inflation comes from: that inflation is essentially evidence that the economy is running too hot, producing goods or services at a level that is not sustainable.

It is a little like revving a car. Once a car is already at top speed, if you push the accelerator harder, you won't go any faster, but you may overheat the engine. Inflation, in this model of how the world works, is the evidence of overheating.

Is that really how the world works?

That's not at all clear.

For one thing, the Phillips Curve relationship hasn't been working quite right in the last decade. The unemployment rate has fallen from 10 percent in late 2009 to 4.1 percent today, and yet wages have been rising at a modest rate, between about 2 and 2.5 percent, throughout that time (at least until the January 2.9 percent gain).

Even as wage gains start to emerge, the relationship between higher wages and overall inflation isn't ironclad, either. For example, the Fed's preferred inflation measure dipped through the first eight months of 2017 despite a low unemployment rate and steady wage gains.

You can imagine a lot of factors that affect inflation that are unrelated to the domestic labor market. Perhaps in a modern, globalized world, when there is a shortage of American workers, companies are better able to outsource service work and import manufactured goods, rather than bid up wages.

If low unemployment spurs new investment in productivity-enhancing machinery, wages could rise without broader inflation breaking out, because higher worker pay would result in higher output, not just more money chasing the same goods.

Or maybe employers have so much power in the labor market now that they can keep wages depressed despite low unemployment, rather than get in bidding wars with one another.

The traditional overheating story might be right. But the recent evidence is hardly definitive.

What does this all have to do with the **stock market**?

The unemployment rate is already low, and the new tax cut may push economic growth even higher. Wall Street knows that if Fed officials think inflation is poised to exceed its 2 percent target, they will raise interest rates to try to stop that from happening.

If the Fed -- under new leadership, as Jerome Powell became chairman this week -- believes it can let the economy roar ahead without inflationary pressure, it will probably continue its recent practice of low interest rates and gradual rate increases, which in turn is good news for stocks.

But if the overheating/Phillips Curve narrative is coming true, the Fed will have to raise interest rates to try to cool the economy, which would make capital more costly for businesses and dampen consumer spending. That's all bad news for stocks.

What happened Friday was that a wage number was published that was consistent with the overheating/Phillips Curve story of how the economy works, which is a big reason markets sold off.

So is high inflation really a risk right now?

For the last decade, the Fed has been more focused on trying to get inflation higher rather than lower, so in some sense the possibility of finally breaking out of that low-inflation, low-growth, low-interest-rate pattern would be welcome.

Right now, prices in the bond market suggest that the Fed is in a sweet spot -- that inflation will indeed hover around 2 percent in the years to come. As recently as August, inflation-protected **bond prices** implied that prices would rise only 1.6 percent a year over the next five years; that is up to 2 percent now.

But there are risks on both sides of that forecast.

One month's wage number doesn't definitively mean that the first step of the overheating story is happening -- low unemployment translating into higher pay for workers. And it definitely doesn't mean that the second step is happening -- higher wages translating into higher overall price inflation.

Seeing how things evolve in 2018 and beyond will be fascinating not just for watchers of the **stock market** and the Federal Reserve, but also for all those who would like to see a bigger paycheck, or who dread what higher inflation might do to their savings.

Stacks of banknotes in Weimar Germany in 1923. Inflation was so high then that currency ceased to be a useful medium of exchange. (PHOTOGRAPH BY ALBERT HARLINGUE/ROGER VIOLLET/GETTY IMAGES) CHART: Inflation Has Been Below the Fed's Target for Years: The Federal Reserve seeks 2 percent annual inflation--and has undershot that target lately. (Source: Bureau of Economic Analysis)

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The New York Times

Washington; SECT
Trump Laments the Stock Market Plunge as a 'Big Mistake'

By MICHAEL D. SHEAR and ALAN RAPPEPORT
611 words
8 February 2018
The New York Times
NYTF
The New York Times on the Web
English

President Trump, who has taken credit for a rising **stock market** as a measure of his own success, complained on Twitter Wednesday that "good (great) news" in the economy led to an abrupt decline in stock prices, his first comments about the **stock market** since its sharp drop earlier this week.

In the early-morning tweet, Mr. Trump lamented that in the "old days," stocks would rise on good economic news, saying "Today, when good news is reported, the **Stock Market** goes down. Big mistake." The tweet did not elaborate on what he meant by the "old days" or explain further his analysis of why stocks plummeted on Friday and Monday.

Until Wednesday's tweet, the president had been unusually silent about the **stock market**, which has been rocked by **volatility**, including a decline in the **Dow Jonesindustrial average** of almost 7 percent over two days. At one point on Monday, the Dow was down almost 1,600 points, or about 6 percent of its total value, the markets plunging at the same moment as Mr. Trump was giving a speech in Blue Ash, Ohio. It closed that day down 1,175 points.

Mr. Trump's assertion that the fall was pegged to good economic news stems from Friday's job report, which showed wages beginning to rise as the economy nears full employment. Rising wages are good for those who receive them, and for the presidents who seek to stimulate them, but investors see them as a sign of possible inflation and higher interest rates. Analysts pegged the sell-off in stocks to the strong employment numbers as investors feared the Federal Reserve might quicken the pace of its interest rate hikes.

White House officials had released only a terse statement after the market's decline earlier this week. Sarah Huckabee Sanders, the White House press secretary, said in a statement on Monday that "the President's focus is on our long-term economic fundamentals, which remain exceptionally strong, with strengthening U.S. economic growth, historically low unemployment, and increasing wages for American workers."

On Tuesday, the Treasury secretary, Steven Mnuchin, tried to walk a fine line in distancing the administration from the recent drop in stock prices while still taking credit for the run of success that preceded it.

"We are very focused on long-term economic growth, and we believe that the policies that we have enacted, including tax reform, are very positive for long-term economic growth," Mr. Mnuchin said at a House Financial Services Committee hearing.

Asked after the hearing if the administration would in the future refrain from embracing the **stock market** as a proxy now that it has become such a **volatile** measure, Mr. Mnuchin made clear that he was not ready to do so.

"We've always been looking at the long-term impact of the **stock market**. It's still up over 30 percent since the election, and we continue to think America is a great place to do business," he said. "We couldn't be happier with companies' response with more and more investments in the U.S."

No president in modern times has connected his political fortunes to the **stock market** as much as Mr. Trump, who relentlessly cited its meteoric rise as a sign of his success at restoring confidence in the American economy. But the drastic sell-off on Friday and Monday demonstrated why most presidents scrupulously avoid talking about short-term gyrations in share prices: If you live by the Dow, you may die by the Dow.

Document NYTF000020180208ee280004k

Business/Financial Desk; SECTB
Searching for Direction, Market Zigzags Lower

By MATT PHILLIPS and JACK EWING
785 words
8 February 2018
The New York Times
NYTF
Late Edition - Final
5
English

Stocks fell Wednesday in a seesaw trading session, as markets sought direction after several tumultuous days of trading.

After registering a 1.7 percent gain on Tuesday, the **Standard & Poor's 500-stockindex** spent much of Wednesday in positive territory, led by large industrial companies positioned to capitalize on global growth and investors hunting for potential bargains from recent selling.

But slumping **oil prices** weighed on the energy stocks throughout the afternoon. Crude oil futures closed down 2.5 percent in New York. Exxon Mobil fell 1.8 percent, and Chevron dropped 1.6 percent. The energy sector, which fell 1.7 percent, helped pull the **S.&P. 500** back into negative territory in the last hour of trading. The broad index fell 0.5 percent.

Other indexes also dropped. The **Dow Jonesindustrial average** slid 0.1 percent, and the **Nasdaq composite** fell 0.9 percent.

Another uptick in interest rates also seemed to dampen what had started out as a relatively decent day for stocks. The yield on the **10-year Treasury** note rose to 2.84 percent after lackluster demand in an auction of $24 billion worth of the benchmark government bonds. Yields on 10-year Treasuries, which serve as the foundation for a range of consumer borrowing rates, are near their highest levels since January 2014.

The steady climb in interest rates has gained pace in 2018. And it has become a concern for investors who believe the low interest rates since the financial crisis have been a cornerstone of the long **bull market** for stocks. Interest rates on shorter-term Treasury bonds, such as the two-year note, have also risen sharply.

Those shorter-term bond yields tend to be sensitive to changing expectations surrounding monetary policy, another source of worry in recent days.

Just a few days ago, the Labor Department's most recent jobs report, which showed the United States economy adding a solid 200,000 jobs in January, helped send markets sharply lower. The report also showed wages growth rising at their fastest pace in years.

Those developments, on their face, should not be bad signs for the consumption-heavy American economy. But some economists consider wage growth an indication that inflation could rise. And investors took the wage data as a reason to worry that the Federal Reserve could raise interest rates more quickly than policymakers had previously suggested.

Stocks fell sharply when the January jobs report was issued on Friday. The sell-off gathered force on Monday when the **S.&P. 500** fell 4.1 percent, its biggest single-day drop since August 2011. The sell-off briefly spread through global markets. But a solid performance by markets in the United States on Tuesday seemed to cool the fire.

With markets in positive territory early Wednesday, President Trump broke his silence on **stock market volatility**, posting a message on Twitter that promoted the health of the American economy and calling the recent sell-off a ''big mistake.''

''We have so much good (great) news about the economy!'' Mr. Trump wrote.

The American economy does indeed appear to have significant momentum. At 4.1 percent, the unemployment rate is low. And the gross domestic product grew at an annual clip of 2.6 percent in the fourth quarter. Recent corporate earnings reports have been solid, with several companies outlining plans to increase investment, in part because of the tax code overhaul that became law in December.

Industrial companies are also piggybacking on that economic strength both in the United States and abroad.

Ball Corporation, a maker of metal packaging like beer cans, was one of the best-performing stocks in the **S**.**&P**. **500** on Wednesday. Shares in Ball, which has plants around the world, rose sharply after the company reported favorable earnings results and cited momentum in its business supplying the aerospace industry. Other large industrial companies, such as Boeing, also rose, helping to lift indexes.

''As we look forward, the market drivers of better economic prospects and higher profits have not changed at all,'' Steven M. Duryee, a portfolio manager at Morgan Stanley's Bergman Continuum Group, a wealth management firm, said in an email to clients.

This is a more complete version of the story than the one that appeared in print.

Follow Jack Ewing on Twitter: @JackEwingNYT.

Traders on the floor of the New York Stock Exchange on Wednesday. Despite the market tumult, the economy appears strong. (PHOTOGRAPH BY RICHARD DREW/ASSOCIATED PRESS) CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters)

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THE WALL STREET JOURNAL.
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Property: Manhattan Real-Estate Sales Stumble --- Buyers are waiting for better deals because they expect tax-law changes to hurt prices

By Josh Barbanel
652 words
8 February 2018
The Wall Street Journal
J
A10B
English

The tax overhaul and its elimination of some tax advantages of owning property have settled like a cloud over the Manhattan real-estate market.

Buyers are becoming convinced that prices are due to fall. Sellers don't agree. The result: a standoff.

The number of contracts signed from October through January was down 6% from the same four-month period a year earlier, according to figures from brokerage Brown Harris Steven. That was the slowest pace of activity during those months since a broad recovery in the Manhattan market began in 2012.

"It used to be location, location, location," said Jonathan Miller, an appraiser and market analyst. "Now it is uncertainty, uncertainty, uncertainty."

Making matters worse, last year's sales were already weak. Brokers and market analysts blamed uncertainty over the presidential election for the lackluster activity in late 2016 and early 2017.

For all of 2017, sales were nearly flat compared with 2016, up 0.6%. Together, the years ranked as the two worst for sales volumes since 2011.

The slowdown intensified as the year went on. Sales in January were down 7.6% from January 2016; in December, sales were 10.7% lower year-over-year.

The tax law, most of whose provisions went into effect at the start of the year, caps deductions for state and local taxes, including property taxes, at $10,000, and limits interest deductions to the first $750,000 of a new mortgage.

Now that the details of the tax bills are better understood, buyers have become convinced prices will come down further, said Hall F. Willkie, the co-president of brokerage Brown Harris Stevens. Sellers haven't come to the same conclusion, he said.

Many brokers have long viewed the Manhattan real-estate market as closely linked to the fortunes of stock markets. Many buyers of expensive properties -- the medianâ€‹sale for a Manhattan apartment is above $1 million -- have investment portfolios and many residents work in finance.

But that relationship, if it existed in the past, broke down over the past year, said Frederick Peters, chief executive of brokerage at Warburg Realty Partnership. While sales slowed, the **stock market** surged.

Now some worry the pullback in the **stock market** in the last few days could add uncertainty, even though rising stocks didn't help before.

"**Volatility** doesn't help anybody," said Noah Rosenblatt, a broker and founder of real-estate search site UrbanDigs.com. "It makes bids for real estate less aggressive. Some will sit it out to see what happens. There are other people who will think this is an opportunity."

The higher-end market, where many purchases are discretionary, has been particularly hard hit of late. In January, the number of contracts signed on listings of $4 million or more fell 29% from January 2017, according to data from Olshan Realty Inc.

It will likely take six months for the market to digest the impact of the new federal tax law on New York real estate, said Donna Olshan, president of Olshan Realty. Some buyers, she said, might decide to look in other states, where state and local taxes are lower. Others will dig in and buy.

"You can't continually put off having a home," she said.

Howard Margolis, a broker at Douglas Elliman, said he was about to list eight properties for between $1 million and $5 million, at a time when buyers are demanding lower prices.

"Buyers are tough" on sellers, he said.

Still, there are signs that some sellers he works with are losing patience and are willing to make concessions.

"The sellers are saying what do I need to do to sell my apartment," Mr. Margolis said. "There are a lot of choices now."

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THE WALL STREET JOURNAL.
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U.S. News: Fed Officials Signal Unchanged Outlook

By Michael S. Derby
250 words
8 February 2018
The Wall Street Journal
J
A2
English

Federal Reserve officials signaled the recent spasm of market **volatility** isn't prompting them to rethink their path of interest-rate increases or upbeat economic outlook.

"I don't think it's a big story at all for central bankers," New York Fed President William Dudley said Wednesday. "If the **stock market** were to go down precipitously and stay down, then that would actually feed into the economic outlook, and that would affect my view in terms of the implications for monetary policy."

Dallas Fed President Robert Kaplan said, "I think it's healthy that there is some correction, a little more **volatility** in markets."

He added that he still favors raising rates in a "patient and gradual manner."

Stocks sold off Friday after new employment data showed strong wage gains in January, causing some investors to worry that inflation might surge and the Fed might raise rates more aggressively to keep price pressures under control.

Then when stocks seesawed Monday and Tuesday, some market participants started thinking the Fed might hold off on rate increases or move less this year than forecast out of concern that the financial gyrations might hurt the economy.

"My outlook hasn't changed because the **stock market** is a little bit lower than it was a few days ago. It's still up sharply from where it was a year ago," Mr. Dudley said.

Document J000000020180208ee2800017

The New York Times

Business Day
For Millennial Investors, a Harsh Lesson in Market Gyrations

By Tiffany Hsu
1,220 words
7 February 2018
06:33 PM
NYTimes.com Feed
NYTFEED
English

Watching the wild swings in the **stock market** has been a heartbreaking experience for Jasmine Okougbo, who started investing only last month.

Ms. Okougbo, 26, a business operations manager in Tucson, has an individual retirement account set up through her company and shares she got from her parents for her birthday. In one week, the value of her investments sank 65 percent.

“I don’t think I will be buying or trading on the market again anytime soon,” she said. “I still don’t think it has hit me how much I lost so quickly.”

For many millennials, the recent **stock market** gyrations have been a painful lesson in **volatility** that is being driven by fears that inflation and interest rates could rise faster than expected. Many have retreated from the market into savings accounts.

Twitter feeds quickly filled with teary, wailing GIFs and heart emoticons cracked in two — pithy punctuation about anemic 401(k) accounts being whittled down to wisps. Many young investors bemoaned the misfortune of equity portfolios shriveling up weeks after their cryptocurrency holdings also began deflating.

Lulled into confidence by the second-longest bull run in history, some had forgotten the passwords to their trading accounts and, to their panic, were locked out.

Mario Tehuitzil, 27, ducked into a restroom to check his cryptocurrency and stock holdings on Monday and felt “a punch to the gut,” then a growing “rush of anxiety and nausea.” His $33,000 stock portfolio had plummeted by more than 40 percent, to $19,000 in value, before swelling back to $24,000 on Wednesday.

“I’m aware of the risks but I never expected this rapid and severe drop,” said Mr. Tehuitzil, a New York-based pediatrics assistant. “Looks like the down payment for an apartment I’ve been eyeing will have to wait.”

Millennials, a sprawling and diverse demographic generally said to be born between the early 1980s and the early 2000s, are known for their passion for social media and an affinity for instant gratification.

But as investors, haunted by the trauma of the Great Recession, they have been mostly cautious. Many young people struggling to find work retreated back to school or into part-time work. For millennials living paycheck to paycheck and sometimes bunking with their parents, saving for retirement seemed a remote priority as they watched debts pile up.

Since hitting bottom in 2009, however, the **stock market** has more than tripled its value. More millennials began venturing into investing, toggling between stock apps and cryptocurrency charts on their phones and boasting of good returns on Twitter and Snapchat.

Rather than turn to professional advisers, who tend to handle much larger amounts than most young people have to invest, many millennials also tapped a growing roster of so-called robo-advisers that offer low-cost, autopiloted portfolio management.

Josh Stillman, 27, was too afraid to look at his retirement account this week but saw on Wealthfront, a robo-adviser he began using last year, that his investments had slumped 3 percent during the sell-off before recovering somewhat.

Mr. Stillman, who produces and hosts digital videos in Los Angeles, said he taught himself about investing by conducting online research and watching YouTube tutorials.

“I feel like my formal education did not educate me at all for investing or planning for my future,” said Mr. Stillman, who has a bachelor’s degree in anthropology from the University of Rochester.

Only about a third of millennials currently hold stocks. And more than 80 percent of young investors — a far higher share than among older age groups — describe their investing strategy as “conservative,” according to survey data released this summer by the Legg Mason asset management firm.

But the survey, conducted as major indexes were surging to new highs amid ostensibly low **volatility**, found that the group expected to eventually take on more risk than their elders. Many have piled into virtual currencies like Bitcoin.

Accustomed to a steadily rising **stock market** and the allure of astronomical gains in cryptocurrencies, millennials have a far different expectation of what typical returns look like compared with investors who have seen more cycles.

Millennials now expect an average annual return of 13.7 percent, compared to the 7.7 percent return that baby boomers expect, according to a survey last year from the AMG asset management company. Young investors are four times as likely as boomers to consider themselves to be highly knowledgeable.

But when the slump overtook the market on Friday, many were stunned.

“They’ve never seen a sell-off like this, and it’s especially scary because they don’t know who to ask for advice — they may not have a relationship with a financial adviser they can call or text to walk them back from the cliff,” said Jason Dorsey, president of The Center for Generational Kinetics, a research firm. “For many of them, it’s been a pretty rude awakening.”

Many millennials are familiar with debt because of their credit cards and student loans. But concepts like portfolio diversification and long-term investing are less well-known, experts said.

“If you haven’t been taught how markets truly work over time, and you don’t have the historical perspective, then bouts of **volatility** like this could cause you to make bad decisions,” said Brian Levitt, a senior investment strategist at OppenheimerFunds.

Many young investors were sanguine about the swings as the **Dow Jonesindustrial average** gained back 567 points on Tuesday after shedding a total of more than 1,841 points on Friday and Monday. On Wednesday, Wall Street edged lower; the Dow lost another 19 points, or 0.1 percent, and the **Standard & Poor**’**s 500**-**stockindex** slipped 0.5 percent.

Paul Whited, 24, lost nearly $800 of the $12,000 in his portfolio as holdings in biopharmacy and technology stocks were walloped. On Tuesday, he made back $300.

The Knoxville-based accounting student began investing actively two years ago. His recent losses hurt, he said, but the **volatility** could present an opportunity to buy.

"Investing in stocks to secure a safe retirement is too important to let fear change my plans,” he said. “I have plenty of time ahead of me to earn my money back and then more.”

Follow Tiffany Hsu on Twitter: @tiffkhsu.

* The Times Answers Your Questions About the Market Turmoil

* How Does Monday’s Stock Plunge Stack Up?

* How Deep Is the Hole the **Stock Market** Just Stepped In?

* Investors Fear the Tax Cuts Will Work Too Well

Mario Tehuitzil, 27, a pediatrics assistant, said he felt a “a punch to the gut” when he learned his investments had dropped more than 40 percent. | Jeenah Moon for The New York Times | Mr. Tehuitzil checked his stock portfolio on his phone. “Looks like the down payment for an apartment I’ve been eyeing will have to wait,” he said. | Jeenah Moon for The New York Times | Josh Stillman, 27, a producer and host of digital videos, learned how to invest from online research and YouTube tutorials. “I feel like my formal education did not educate me at all for investing or planning for my future,” he said. | Coley Brown for The New York Times

Document NYTFEED020180207ee2700912

THE WALL STREET JOURNAL.
U.S. EDITION

For Bank Trading Desks, Wild Swings Bring Opportunity

By Max Colchester, Jenny Strasburg and Liz Hoffman
828 words
7 February 2018
The Wall Street Journal
J
B14
English

Banks have blamed placid markets for lackluster returns in their big trading operations. This week, they are cheering the big market swings, seeing hope for a boost in fees that dropped off a cliff last year.

"Anything that brings back **volatility** would be good," said Peter Tchir, macroinvesting strategist at New York-based Academy Securities LLC. "Maybe we could see a return to better quarters" for banks across their fixed-income trading businesses, from currencies to interest-rate hedging.

Dull markets during most of 2017 pushed lenders' trading revenue to historic lows as clients saw little reason to shuffle investments or buy derivatives to hedge risks in ever-rising markets. Now, as stocks have plunged recently on expectations of rising bond yields and higher inflation, the same banks, analysts and investors see a brighter picture. On Tuesday in the U.S., stocks rebounded, with the **S&P 500** ending the day up 1.7%.

Trading volume for the shortest-duration U.S. Treasury bills hit their highest monthly average in January since October 2008, according to data from trade group Securities Industry and **Financial Markets** Association. Corporate-bond trading volume jumped to $29 billion a day in January from $18 billion a day in December, while stock trading volumes hit a seven-month high.

And with expectations of interest-rate increases, traders report higher demand for hedges, swaps and other instruments that protect investors from the effect of rate swings.

"Is it the light at the end of the tunnel? No. Is it temporary relief? Yes," said George Kuznetsov, global head of research at London-based consulting firm Coalition.

The renewed **volatility** in the market may push revenue on trading desks up by 10% to 15% in the first quarter of this year, Mr. Kuznetsov said. Foreign exchange, macro trading and credit trading are expected to be the big winners of the market moves, said analysts.

One risk for trading desks is that they will get too much of a good thing. Excessive **volatility**, particularly when asset prices depreciate, can chill investor appetite to trade more. And banks and dealers often hold inventories of stocks and bonds that they have to mark down in value during a broad selloff in prices.

For now though, the focus is on staying busy. Asian markets saw a rush of panic selling Tuesday, compared with calmer, more measured European markets, London traders said. Japan's Nikkei Stock Average dropped 4.7%, while the U.K.'s FTSE 100 fell 2.6%.

"Market conditions can change and turn rapidly, and they have," Martin Chavez, Goldman Sachs Group Inc.'s chief financial officer, told analysts on a January earnings call.

It is too early to tell whether recent **volatility** will sustain better revenue in the long term, bankers and analysts said. Over the past few years, big market swings, such as those around the U.K. Brexit vote, were followed by periods of calm.

Banks need a steady drumbeat of market churn to keep business flowing.

"The pull-through to trading requires a bunch of things: increased **volatility**, client activity, market events, central bank actions. All of those things could be drivers for greater activity," Mr. Chavez told analysts on the January earnings call.

There are some signs that the trading freeze is starting to thaw. Even before the wild market ride of recent days, investment banking chiefs sounded more upbeat about the first quarter of the year, which is traditionally a busy time for them.

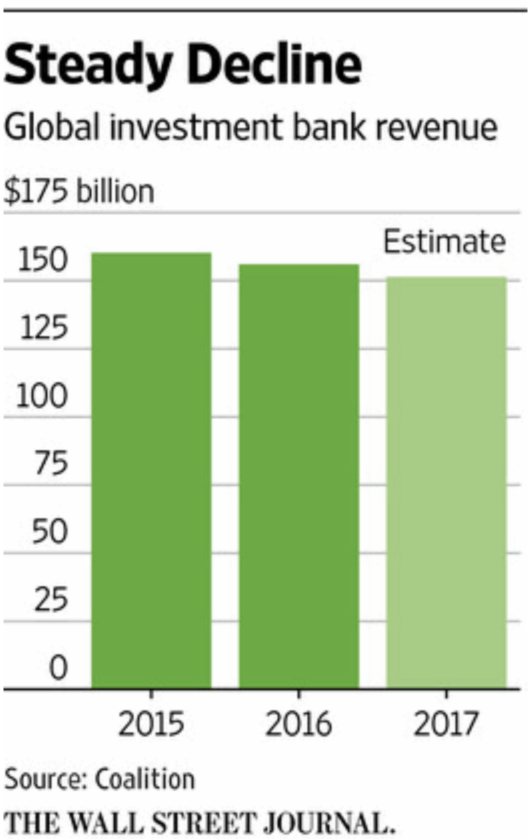
Credit Suisse Group AG Chief Executive Officer Tidjane Thiam said in interviews at the World Economic Forum in Davos, Switzerland, last month that the Swiss bank sees a strong pipeline of deals coming through that it expects to be reflected in first-quarter numbers. UBS Group AG CEO Sergio Ermotti said at the start of the year that he expected **volatility** to return to the market.

Banks are starting from a low base. Full-year 2017 revenue across the investment banking industry was on course to decline 3% to 5% compared with the previous year, the worst since the financial crisis, according to consulting firm Oliver Wyman.

There is little chance of trading desks morphing back into the megarevenue generators of yesteryear. Greater capital requirements have made it harder for banks to take on the risks they once did.

Banks have already cut thousands of trading jobs to pare costs. And not all **volatility** brings good news. Fees from merger advising, debt issuance and initial public offerings could be dented as clients put deals on ice.

Still, the boost in trading revenue could generate hundreds of millions of dollars for banks if the market **volatility** continues through the quarter, said Jonathan Wills, a London-based partner at Oliver Wyman. "It is going to be a good thing for sales and trading franchises," he said.



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The New York Times

California Today
U.S.
California Today: How a Market Tumble Affects California

By Matt Stevens and Julie Turkewitz
1,075 words
7 February 2018
09:12 AM
NYTimes.com Feed
NYTFEED
English

Good morning.

(Want to get California Today by email? Here's the sign-up.)

"Sell off!" "Crash!" Investors bracing for "uncertainty."

After plummeting early this week, Wall Street rallied on Tuesday, recovering some, but not all, of what had been lost. What implications does the drop have specifically for California?

In an interview on Tuesday afternoon, Annette Vissing-Jorgensen, a professor of finance at the University of California, Berkeley's Haas School of Business, put the market decline in context for the Golden State.

Here are some things to keep in mind:

The market's impact on capital gains – and the state budget

When the **stock market** goes down, the amount of money Californians who sell stock must pay in capital gains taxes also decreases. The state's tax code is very progressive, which, in this case, Dr. Vissing-Jorgensen said, compounds the problem.

California has one of the highest top tax brackets in the country, and the state relies heavily on those top earners to fill its coffers. (In 2014, the top 1 percent of earners paid 48 percent of all state income taxes in California, according to a 2016 article in the Economist.)

"Since the top 1 percent of Californians own a lot of stocks, a **stock market** decline that results in lower capital gains could have a disproportionately large impact on California – and its state budget," Dr. Vissing-Jorgensen said.

We have a lot of tech companies in California – and their stocks tend to feel the impact of market movement more acutely

Tech companies like, say, Apple, tend to sell products known as "consumer durables" – products like an iPhone that do not have to be bought frequently because they last for a long time. When people are feeling strapped, they tend to cut back on buying those types of products.

Those companies tend to be "high beta," Dr. Vissing-Jorgensen said, meaning that tech stocks move more than "one for one" with the **stock market**. Companies like Apple, she said, have a beta above one, meaning that a 10 percent drop in the market tends to be associated with a larger than 10 percent drop in their stock prices.

"The industry composition of our businesses matters because some industries like tech are more affected by the underlying economic drivers of the **stock market** decline," Dr. Vissing-Jorgensen said.

The big picture

All that said, Dr. Vissing-Jorgensen urged people to keep things in perspective.

“The **stock market** has declined, but it’s a pretty modest decline compared to how much the run up has been,” she said. “It’s now basically flat for this year, but it still went up a huge amount last year.”

California Online

(Please note: We regularly highlight articles on news sites that have limited access for nonsubscribers.)

• The billionaire Los Angeles doctor Patrick Soon-Shiong is close to buying The Los Angeles Times from its parent company Tronc in a $500 million deal that would happen as early as Wednesday. The move follows months of turmoil at the paper. [The New York Times]

• Elon Musk’s SpaceX company launched the world’s most powerful rocket, with a Tesla sports car as payload, into space. [The New York Times]

• But editorial writers are turning their attention to Mr. Musk’s other pursuits, blasting his sale of thousands of flamethrowers and calling him a “self-centered child in a grownup’s body.” [Mercury News and East Bay Times]

• New polls show that a majority of voters are not looking favorably at a pair of Southern California Republicans. This could spell bad news for their colleagues in the rest of the state. [San Francisco Chronicle]

• The Los Angeles County district attorney is not planning to follow her counterparts in San Francisco and San Diego, who are dismissing thousands of marijuana convictions. [KQED]

• The Southern Poverty Law Center has identified 13 “alt-right killers” whose actions have left 43 people dead. Among them was Elliot Rodger, who killed six people in the college town of Isla Vista in 2014. [The Los Angeles Times]

• San Francisco could open a pair of safe injection sites as early as July 1, making it the first city in the nation with clinics that allow drug users to shoot up with supervision. The method is controversial, but cities from Seattle to Baltimore are examining their own sites. [San Francisco Chronicle]

• The Olympics begin Friday. These are the California athletes to watch. [Sacramento Bee]

• The Girl Scouts aren’t sure what to do with a 9-year-old who sold 312 boxes of cookies outside a pot shop. Urbn Leaf was apparently not on the approved cookie booth list. [San Diego Union-Tribune]

And Finally ...

The year was 1968, and California-born Peggy Fleming took to the ice at the Stade de Glace in Grenoble, France — a 19-year-old with a shot at Olympic gold. Just a few years before, a plane crash had killed the entire American figure skating delegation, wiping out a generation of top skaters.

Deafening applause rolled through the rafters, according to coverage in The New York Times. Ms. Fleming wore chartreuse. Rhinestone glittered under the lights.

[Video: Watch on YouTube.]

“Here they were, one after another—the double loop, the double axel, the Wally jump, the ballet jump, another Wally, the flying camel and the double lutz,” wrote our reporter. “Peggy was nearing the end now—her skates flowing onto the ice and there suddenly was the finale—a half-toe loop, one-and-a-half toe loop, then a double-toe loop, perfectly conceived, perfectly executed.”

Ms. Fleming took home the nation’s only gold medal in that Olympics, and her victory became a global symbol of the resurgence of U.S. figure skating.

California Today goes live at 6 a.m. Pacific time weekdays. Tell us what you want to see: CAtoday@nytimes.com.

California Today is edited by Julie Bloom, who grew up in Los Angeles and graduated from U.C. Berkeley.

Outside the New York Stock Exchange this week. | Sam Hodgson for The New York Times | Patrick Soon-Shiong | Kevork Djansezian/Getty Images | Activists in San Francisco calling for the removal of Judge Aaron Persky. | Eric Risberg/Associated Press | Students at the University of California, Santa Barbara attended a vigil after a 2014 shooting in Isla Vista. | Jonathan Alcorn/Reuters

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THE WALL STREET JOURNAL.
U.S. EDITION

Streetwise: Inflation Could Eat Market Alive

By James Mackintosh
751 words
7 February 2018
The Wall Street Journal
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English

Markets work best when the players have a mix of different time horizons.

Short-term traders spent Monday night tied up in assessing the impact of bets against **volatility** on their portfolios (short version: not looking good). Those with a longer-term outlook should be considering whether this is a buying opportunity. Much depends on their view of how companies will respond to President Donald Trump's tax cuts, but not all of it.

The basic question comes down to how stocks and bonds should interact. On Friday, rising bond yields were bad news for stocks. On Monday, the opposite was the case, with bond yields falling all the way back, and stocks falling perfectly in line with them.

This interacts with U.S. tax cuts in some complex ways, with two key variables: inflation and fear of inflation. From September until the start of last week almost all the rise in bond yields was due to a reassessment of what the Federal Reserve would do over the next decade.

A minority of that reassessment was because inflation was expected to be higher, pushing the Fed to tighter monetary policy, but the majority was because long-run growth was expected to be higher, allowing the Fed eventually to raise rates further than previously thought without harming the economy. In economic terms, the theoretical interest rate r* -- the rate compatible with steady inflation when the economy is at full capacity -- went up.

In other words, investors believed in a combination of global economic growth and that the tax cuts would encourage companies to invest and boost U.S. productivity. Bond yields went up, but that was good news for stocks because it reflected growth, most of it real, which is good for profits. With inflation far from worrisome levels, even a bit of inflation wasn't bad news.

Last week was quite different. Bond yields kept going up, but it wasn't because investors expected more Fed increases. Instead, it was because investors were less certain about the path of inflation and so of rates, and so demanded an extra reward to compensate them for this uncertainty. In bond-market jargon, the extra is called term premium.

For shareholders, bond yields pushed up by a rising term premium is all bad news. It means borrowing costs are higher. It means future profits are less valuable when discounted back to today at the higher rate. It means bonds are a more attractive alternative to stocks. And, crucially, it does nothing to help future profits.

Even worse, inflation expectations suddenly started to rise fast, too. Shares usually fare better than bonds from inflation, but real growth is best. Inflation pushed up by fast-rising wages -- as Friday's headline jobs data suggested -- isn't great for stocks, since rising wages hit profit margins. Companies might make it back from higher sales, but wage bills are more certain than revenue growth.

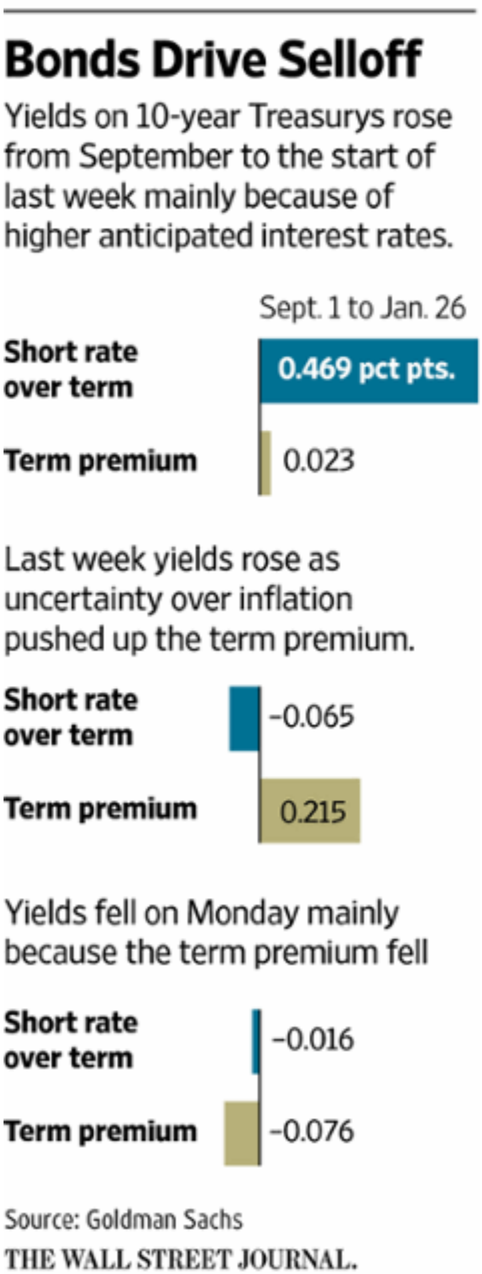
The pattern switched back on Monday. As markets went into free fall the **bond yield** fell because the term premium compressed again, according to Goldman Sachs's calculations.

Investors considering the future of stocks have to weigh these two factors. First, will the tax cuts (and at a broader level global economic growth) lead mainly to productivity-enhancing capital spending by companies, or will companies just feed it back to shareholders, consumption and inflation? If productivity is about to pick up, that helps justify high valuations because the economic cycle will be extended.

Second, are investors overconfident about the outlook for inflation? The 10-year term premium is very low -- it turned positive on Friday for the first time since July, Goldman estimates, before falling back on Monday -- showing investors still believe strongly in the "new normal" of low and steady inflation. There is plenty of scope for inflation surprises to shock bondholders again, and as we saw on Friday bond yields rising because of inflation uncertainty is bad news for stocks.

There are other issues for the long-term investor, of course: Shares, especially in the U.S., are very expensive, profit margins are very high and so are corporate debts.

But when it comes to worrying about bonds, the question is whether higher yields are good or bad. Even those who think Mr. Trump can achieve sustainable faster real economic growth should worry about the danger that inflation surprises make higher bond yields bad again.



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U.S. News: Wage Growth Hit in Pockets

By Eric Morath and Nick Timiraos
673 words
7 February 2018
The Wall Street Journal
J
A2
English

A Labor Department report last week on rising U.S. wages fed market inflation fears and touched off a swoon still sweeping through global markets. But a deeper look at that report raises questions about whether wages and inflation really are rising in such threatening ways.

Average hourly earnings for all private-sector workers increased 2.9% in January from a year earlier, the best gain since June 2009, according to the Labor Department.

Stronger inflation could cause the Federal Reserve to act more aggressively to lift interest rates in an effort to prevent the economy from overheating but could depress stock prices.

But wage gains aren't widespread. A separate gauge in Friday's report showed wages for nonsupervisory workers, who account for about 80% of employment, rose just 2.4% for the 52 weeks ending in January, in the same range that has prevailed for several years.

Almost all of the gain in Friday's report came from the smaller subset of supervisors and nonproduction workers, who saw wages rise 5% on the year.

This measure is **volatile**. The monthly gain in wages for this group, which was 0.8% in January, carries with it a margin of error of 0.66%, notes Ian Shepherdson, chief economist at Pantheon Macroeconomics.

"It would not surprise me in the least if this reverses in February," he said.

This isn't the first time the small subset of managerial workers has seen a big uptick in monthly pay. Wages for this group rose 1.2% last February and 1% last July, pushing overall wages up 0.3% in both months, a pace that wasn't sustained in the following months.

Overall annual wage growth reached 2.8% in July 2016 but didn't maintain that pace of growth.

Other components of Friday's report also make the banner wage gains less impressive. The average workweek declined in January. As a result, the annual change in weekly wages for all workers rose 2.6% on the year, below gains of 3% in December and 3.1% in November.

A broader look at Americans' after-tax incomes, including wages, dividends, bonuses and Social Security checks, shows an improving trend over the second half of last year. But the gains are less than the pace at other times in this expansion.

The question for the Fed is how quickly higher wages will translate into inflation. This will determine how quickly and for how long officials proceed with rate increases.

Most Fed officials haven't shied away from their fundamental view, embodied by the so-called Phillips curve, that tighter labor markets will drive stronger wage growth and more inflation. But the link isn't immediate or rapid, and some officials say skepticism is warranted.

"I caution against interpreting good news from labor markets as translating directly into higher inflation," said St. Louis Fed President James Bullard in a speech in Lexington, Ky., on Tuesday.

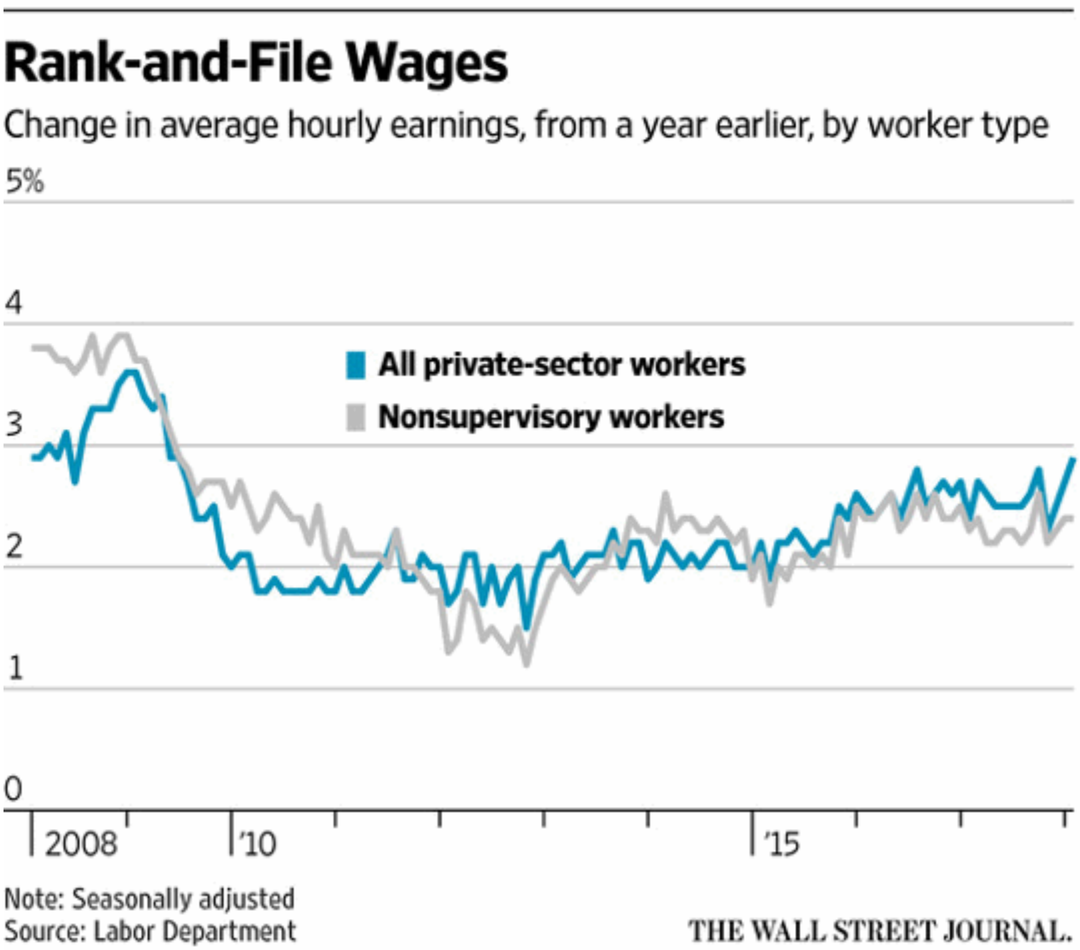
He said the relationship between inflation and labor-market conditions "has broken down in recent years and may be zero."

During the last two expansions, annual wage growth peaked at 4%. Why are investors now worried that as wage growth nears 3%, the Fed might lean on the brakes by raising interest rates faster?

One possibility is that officials expect worker productivity, which has been lower over the past decade, won't pick up. If productivity rises, officials can tolerate higher wage gains because they won't necessarily push consumer prices higher.

The prospect of higher inflation and higher rates weighs on stock valuations. But for now, markets aren't sending signals that they see the economy slowing down. One piece of evidence is that market-based measures of inflation expectations haven't declined.

"If the market expected the correction to trigger a recession, then inflation expectations would also have crashed yesterday," said Torsten Slok, chief international economist at Deutsche Bank.



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Stocks Rebound In Volatile Trading

By Asjylyn Loder, Gunjan Banerji and Alexander Osipovich
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7 February 2018
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A1
English

Stocks rallied Tuesday, a day after the **Dow Jones Industrial Average** suffered its biggest one-day point decline ever. But another round of wild price swings raised new questions about whether **volatility** was emerging as a threat to the nearly nine-year old **bull market**.

The Dow ended the day 2.3% higher after swinging 1,167.49 points from its intraday low to its high. The **S&P 500 index**, which lost nearly $1 trillion in market value on Monday, gained 1.7%, and the **Nasdaq Composite** rose 2.1%.

The sudden return of **volatility** nearly wiped out the assets of some popular exchange-traded products that allow investors to bet on continued calm.

Japanese securities firm Nomura Holdings Inc. and Swiss bank Credit Suisse AG announced Tuesday that they would close two exchange-traded products that saw more than 80% of their value erased when **volatility** spiked. U.S. exchanges temporarily halted trading in similar products.

Betting against wild price swings has been one of the most profitable trades in recent years as central bankers flooded the markets with cash and lulled investors with record-low interest rates. But Monday's sharp decline in stocks, followed by an abrupt surge in an index measuring stock **volatility** that is known as Wall Street's fear gauge, triggered a spectacular unraveling.

While the exchange-traded products were the most visible victims, other investors were similarly blindsided by the sudden surge in **volatility**. Tony Caine, founder and chairman of Chicago-based LJM Partners Ltd. -- which focuses on **volatility** strategies -- told investors in a letter Tuesday that "LJM strategies have suffered significant losses," according to a copy of the letter obtained by The Wall Street Journal.

"This is the **volatility** event that we've been waiting for," said Chris Hausman, director of risk management and chief technical strategist at Swan Global Investments. "A lot of people have become complacent."

Before the abrupt reversal, global stocks had climbed higher in 2018 amid a drumbeat of positive economic news, including corporate tax cuts, rising wages and strong company earnings. Investors in January poured $102 billion into mutual funds and exchange-traded funds that invest in stocks globally, according to Bank of America Merrill Lynch. The steady upward march prompted more investors to bet that the Cboe **Volatility** Index, a measure of traders' expectations for market moves, would remain near record lows.

"A lot of people have never seen a **bear market**," said Melissa Brown, managing director and head of applied research at Axioma. "These big events scare a lot of people and then it becomes a self-fulfilling prophecy."

Nowhere was the market's change in sentiment more glaring than in Wall Street's fear gauge. The **volatility** index, known as the VIX, spiked in unusual late-day trading Monday afternoon. The price of futures pegged to the VIX nearly doubled Monday, with much of the increase occurring in just 15 minutes of afternoon trading.

The VIX was invented 25 years ago as a way to warn investors of an imminent crash, but it has since morphed into a giant casino of its own. The measure uses options on the **S&P 500 stock index** to measure traders' expectations for near-term market swings.

The advent of VIX exchange-traded products in 2009 made it possible for investors to trade **volatility** alongside the most sophisticated hedge funds in the world. Since the VIX rises when stocks fall, it made an attractive form of insurance in the aftermath of the financial crisis.

Investors flooded into products that profit when **volatility** rises. But fear faded as the market pushed steadily higher, and those products hemorrhaged money. So instead of buying insurance, investors started selling it. Some placed their bets directly in futures and options, while others bought into exchange-traded products that profit when VIX futures decline.

The strategy has been enormously profitable as the **stock market** surged and **volatility** remained muted. Both the ProShares and the VelocityShares products more than doubled in the 12 months ended Feb. 1.

Since the start of the year, the ProShares Short VIX Short-Term Futures ETF and the VelocityShares Daily Inverse VIX Short-Term exchange-traded notes -- the two largest short-VIX products -- took in $2.2 billion combined, nearly doubling their combined assets to more than $4 billion as of Feb. 2, according to FactSet.

But those strategies amplify stock losses when markets turn, as investors learned Monday night, when both the ProShares and the VelocityShares products lost more than 80% of their value in after-hours trading.

The losses were triggered by a late-day surge in VIX futures prices. A series of massive buy orders flooded into the futures market after the close of the U.S. **stock market** at 4 p.m. in New York. The VIX futures market closes 15 minutes later. In those final moments, VIX futures surged to $33.20, more than double where they had started the day, according to data from FactSet.

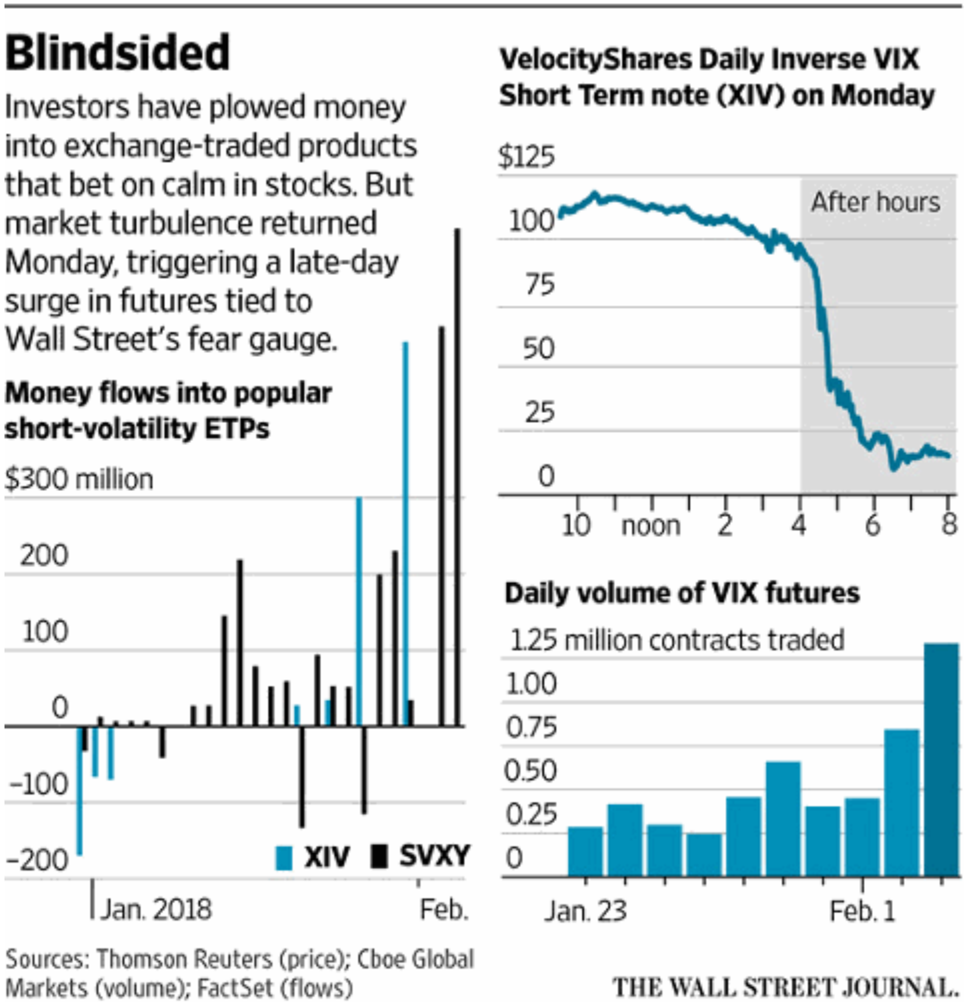
Nick Ravo says he owned the VelocityShares product in his retirement account, and watched as his investment was almost completely erased.

"I watched it sink, sink, sink after hours," he said.

After settling at $99 a share, the VelocityShares product was worth $4.22 a share by Monday evening. On Tuesday morning, Credit Suisse announced that it would close the product Feb. 21.

Trading was temporarily halted Tuesday morning in the ProShares ETF. When trading reopened, shares were at $11.70 -- an 88% drop from the start of trading on Monday.

Mike Bird and Gregor Stuart Hunter contributed to this article.



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The New York Times

Feature
Magazine
The Rise of China and the Fall of the 'Free Trade' Myth

By Pankaj Mishra
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NYTFEED
English

'America first does not mean America alone," President Trump declared last month at the World Economic Forum in Davos, Switzerland. This sudden burst of pragmatism from an avowed nationalist showed what a difference a year can make. Denouncing the "false song of globalism" during his presidential campaign, Trump, on his third full day in office, canceled the Trans-Pacific Partnership, a regional trade deal with Japan and 10 other countries. He then denounced Canada, Germany and South Korea for exporting more to the United States than they import. He promised to renegotiate trade pacts with Europe, Canada and Mexico and get a better deal for American workers. In Davos, however, he reached out with conciliatory words to the very free-trading and globalizing elites he has consistently maligned.

Clearly, Trump's views on trade and globalization have evolved since his insurgent campaign. This may well be because of the rapid gains in the past year of a country he did not mention by name. In fact, Trump chose in Davos to affirm that "America is open for business" because it was in these same Alpine heights, three days before Trump was inaugurated as president, that China seized the opportunity to claim leadership of the global economy. With the United States seemingly in a protectionist crouch, China had become, despite all its problems, indispensable. "In a world marked by great uncertainty and **volatility**, the international community is looking to China," Klaus Schwab, the founder of the World Economic Forum, said last year while introducing his guest, the Chinese president and general secretary of China's Communist Party, Xi Jinping.

As the usual gaggle of hedge-funders, Silicon Valley executives and government officials looked on, Xi rose to defend free trade and globalization against the relentless attacks of Trump. "Some people blame economic globalization for the chaos in our world," Xi said. "One should not retreat to the harbor when encountering a storm, for this will never get us to the other shore of the ocean." Xi then confidently quoted Dickens. "'It was the best of times, it was the worst of times.' These are the words used by the English writer Charles Dickens to describe the world after the Industrial Revolution. Today, we also live in a world of contradictions."

Never mind that Dickens was actually describing the world before the French Revolution. Xi's claim of openness was, to say the least, riddled with contradictions of its own. It is increasingly difficult for foreign companies to do business in China; Beijing's "Made in China 2025" industrial policy aims to increase "indigenous innovation" and self-reliance. When Trump, a year later in Davos, denounced such "unfair economic practices" as "industrial subsidies and pervasive state-led economic planning," there was little doubt which nation he had in mind.

Yet Xi is entitled to some of his rhetorical point-scoring. The financial crisis of 2008 greatly weakened the American economy, but it left China relatively unscathed. More important, China, whose share of world trade in the mid-1970s was less than 0.5 percent, is today the world's leading exporter — the hub of new and increasingly dense transcontinental trading networks that bypass the United States. "When the United States grows, so does the world," Trump claimed in Davos. But America's status as the linchpin of the global economic order is now endangered. The trading system China dominates has reduced the long dependency of Latin American and sub-Saharan African countries on American and European markets. China is now bringing to a close the first phase of globalization, begun by Europe and the United States in the 19th century. In the process, it is making East Asia the new center of the world economy.

It has fallen upon Trump, as president of the United States, to respond to this momentous historic shift, and he has done so with his characteristic mix of threats, boasts and volte-faces. But to grasp China's economic achievement, and its ramifications, it is imperative to ask: Why has a market economy directed by a Communist state become the world's second-largest? Or, to rephrase the question: Why shouldn't it have? Why shouldn't

China's rise have happened the way it did, with state-led economic planning, industrial subsidies and little or no regard for the rules of "free trade"?

The economic success of East Asian countries like Japan in the 20th century had already invalidated the article of faith invoked by Trump in Davos: that nations can advance only by eliminating barriers to the free movement of goods and capital and by minimizing the role of government in the economy. But these historical lessons have long been obscured by economic orthodoxy, one that Trump's — and China's — unexpected ascents have now exposed to critical scrutiny.

In his most recent book, "Straight Talk on Trade," the Harvard professor Dani Rodrik castigates fellow economists for holding fast to a simple-minded view of free trade and globalization, one that he believes has caused economic chaos and political backlash across the West. "Are economists," he asks, "responsible for Donald Trump's shocking victory in the U.S. presidential election?" This might be overstating the case. But it is true that the argument that free markets equal progress was most eloquently and influentially advocated by the American economist Milton Friedman.

The paradoxes of China's rise today are best illuminated by Friedman's querulous visit to the country in 1980, when China was desperately poor. The Nobel laureate from Chicago was then cementing his reputation as an apostle of free markets. He had just published "Free to Choose," a book that was written with his wife, Rose, and later turned into a television series featuring, among others, Ronald Reagan, Arnold Schwarzenegger and Donald Rumsfeld. Friedman's argument, that "the world runs on individuals pursuing their separate interests," would shape American economic policy for decades to come. He helped disparage the idea, exemplified most vividly by Franklin Roosevelt's New Deal, that government had a legitimate, and often indispensable, role to play in advancing economic development and protecting the vulnerable. As his keen disciple Reagan famously put it, "Government is not the solution to our problem; government is the problem."

Friedman's fervent advocacy of free trade and the efficiency of unregulated markets gave intellectual ballast to the so-called Washington Consensus. Free markets, the thinking went, not only generated wealth for all nations but also maximized consumer choice, reduced prices and optimized the use of scarce resources. Friedman's faith in the efficiency of markets came to constitute what John Stuart Mill referred to as "the deep slumber of a decided opinion."

Friedman was the most influential proponent of free trade since Adam Smith declared it, in 1776, the basis of the wealth of nations. But in 1980, few people in China, including the academics who invited Friedman to a lecture tour, knew that their American guest was an impatient, even **volatile**, ideologue.

A series of (often comical) misunderstandings ensued. Friedman complained about the Chinese man with a "terrible body odor" who received him at the Beijing airport; the man turned out to be one of his academic hosts. Friedman's lectures in praise of free markets were met with bewilderment. His assertion that capitalism was superior to socialism disturbed the Chinese greatly. Some of the more agitated Chinese economists went in a delegation to Friedman's hotel to lecture him about the achievements of their regime.

Friedman, who (erroneously) saw Japan and South Korea as brilliant examples of open, competitive markets, was understandably impatient in China; the country embodied everything that was wrong with government planning. Indeed, China in 1980 was just lurching out of Mao Zedong's calamitous experiments. Deng Xiaoping's government was trying to improvise new solutions to the country's economic backwardness, which officials thought had exposed China to humiliation in the 19th and early 20th centuries. "Development," Deng said, "is the only truth. If we don't develop, we will be bullied." And national development, in Deng's view, could be achieved by a variety of means. His flexible attitude was summed up by a much-popularized Chinese maxim: "Cross the river by feeling for the stones."

The Chinese couldn't help bristling at Friedman's blunt dismissals of their government. Despite horrific disasters, the Chinese state had drastically raised literacy and life-expectancy levels. Also, the Chinese were then seeking a third way: They looked to Japan and Singapore rather than the United States for economic models that would accelerate growth without endangering the authority of the Communist Party. The Chinese saw little of value in an American proponent of laissez faire. Friedman left China, angrily claiming that his hosts were "unbelievably ignorant about how a market or capitalist system works."

Friedman died in 2006, shortly before the financial crisis of 2007 and 2008. The extensive political aftershocks of that crisis arguably include the election of a protectionist to the highest office in the United States, who has threatened to cancel decades of commitments to free trade at the risk of alienating his country's closest allies.

As bewildered (and appalled) as Friedman would most likely have been by Trump's demonization of free trade, he would have found it still harder to explain why China, run by a Communist Party, has emerged as central to the global capitalist economy. For the Chinese regime achieved this not by liberating its 1.4 billion citizens to maximize their private interests in unfettered markets but by controlling its currency, owning large businesses and intervening heavily in investment decisions by private companies.

Indeed, economic history reveals that great economic powers have always become great because of activist states. Regardless of the mystical properties claimed for it, the invisible hand of self-interest depends on the visible and often heavy hand of government. To take only one instance, British gunboats helped impose free trade on 19th-century China — a lesson not lost on the Chinese. Britain was protectionist before it was a free-trading nation. The United States itself was, while industrializing, the "mother country," as the economic historian Paul Bairoch wrote, "and bastion of modern protectionism." Its average tariffs in the late 19th century were nearly as high — 45 percent — as the steepest ones Trump has slapped on imports of washing machines. The philosophical father of economic protectionism is, in fact, Alexander Hamilton, the founder of the American financial system, whose pupils included the Germans, the Japanese and, indirectly, the Chinese.

No story is as instructive as that of the Japanese, arguably the most diligent of Hamilton's disciples. Post-1945 Japan preceded China as the hub of regional and intercontinental trade networks. Soon after its disastrous part in World War II, Japan helped revitalize Asia and by the mid '90s was the biggest investor and exporter in most East Asian countries; it gave more foreign aid and sent more tourists to them and was the biggest buyer of their raw commodities. What's more, it offered a model for development that combined a market economy with state intervention — one that China was even then beginning to learn from.

How did Japan, a country devastated by a world war that had few natural resources of its own, achieve economic primacy in Asia? Friedman's explanation in "Free to Choose" was that "free trade set off a process that revolutionized Japan and the lives of its people." Francis Fukuyama, who proclaimed the end of history in 1989, credited Japan's success to "economic liberalism" of the kind espoused by Adam Smith. But the Japanese followed a very different model, one adopted from Hamilton.

Japan learned early the political risks of economic stagnation. At the height of 19th-century imperialism, it signed a humiliating treaty that subjected its trade policy to the control of five Western powers, deprived it of the right to impose tariffs, set radically low import duties and gave foreign residents in trading ports extraterritorial status. Smarting from such insults, the conservative Meiji rulers of Japan became obsessed with regaining their sovereignty and protecting themselves from foreign tormentors.

In this endeavor, they looked to Germany. Unified in 1871, Germany was scrambling to catch up with industrialized Britain. To do so, it borrowed from recipes of national development proposed by Hamilton soon after the Americans broke free of their British overlords. In his "Report on the Subject of Manufactures," submitted to Congress in 1791, Hamilton used the potent term "infant" industries to argue for economic protectionism. Hamilton's father was Scottish. Born in the West Indies, then a British colony, Hamilton was keenly aware of how the British practiced protectionism: preventing colonies from competing while selling their own goods around the world. In his view, infant nations needed room to maneuver before they could compete with established industrial powers. The United States embraced many of Hamilton's recommendations; the beneficiaries were, first, the textile and iron industries and then steel.

It was Hamilton's formula, rather than free trade, that made the United States the world's fastest-growing economy in the 19th century and into the 1920s. And that formula was embraced by other nations coming late to international economic competition. Hamilton's most influential student was a German economist named Friedrich List, who lived in the United States from 1825 until the 1830s and wrote a book titled "Outlines of American Political Economy." On his return to Germany, List attacked the free-market gospel preached by Britain as sheer opportunism. In his view, the British could afford to kick away the ladder of protectionism they had climbed to the summit of global industry and manufacture. He was all for free trade, but only after young industries had been nurtured in a protective environment. Applying List's lessons, Germany moved with spectacular speed from an agrarian to an industrial economy.

The stakes were higher for Japan. There was hardly a country in Asia that had not been forced by Britain, Holland and France into unequal trade agreements. Economic liberalism was not a feasible option. The visible hand — the state rather than the market — was needed to guide development. Closely following Germany's example, Japan heavily subsidized its first factories, copied British design and imported foreign machinery and engineers. It not only protected many of its businesses from excessive competition but also guaranteed them a minimum profit.

When World War I disrupted Europe's monopolies in its Asian colonies, Japanese companies moved in with their textiles, bicycles and canned foods. Following Europe's free-trading imperialists, Japan had invaded and occupied Taiwan and then Korea, turning them into protected markets for its small industries. In a further refinement, the Japanese state bribed and coerced manufacturing companies. It gave them subsidies to export more, which in turn helped the companies fund innovations and become internationally competitive.

World War II proved only a brief interruption in Japan's policy of protection. Utterly devastated, Japan still managed to rid Asia of its European competitors. It was during the American occupation, as the historian John Dower notes, that Japan instituted what an economist described as the most "restrictive foreign-trade and foreign-exchange control system ever devised by a major free nation."

Given unlimited powers by their American occupiers to get the country going again, the bureaucrats of Japan's Ministry of International Trade and Industry laid the foundations of a world-class manufacturing economy. Nationalism was a great stimulus. As Dower put it, "National pride — acute, wounded, wedded to a profound sense of vulnerability — lay behind the single-minded pursuit of economic growth that created a momentary superpower a mere quarter-century after humiliating defeat." But Japan would have struggled had war not erupted on the Korean Peninsula in 1950 and made Japan the main source of American procurements. The path of Japan's protectionist state was now set — the country's prime minister, Shigeru Yoshida, would call the destructive Korean War a "gift of the gods."

In the 1950s, Korea and Taiwan, both former Japanese colonies, inherited Japan's institutions and protectionist practices. This was most striking in Korea, which was intensely poor in the early 1950s; its few industries were built by Japan during the 1930s. South Korea, too, found solutions for its problems in Friedrich List rather than Adam Smith. The country's leader, Park Chung-hee, the military general who came to power in 1961, had worked for the Japanese colonialist regime. A fervent autodidact, Park was also deeply familiar with German theories of protectionism. (The economist Robert Wade reported coming across whole shelves of books by List in Seoul bookstores in the 1970s.) During his long years in power, Park nurtured South Korea's chaebol business groups — Hyundai, Daewoo and Samsung — and boldly ventured into steel-making.

Because the United States saw Korea, Taiwan and Japan as a buffer against Communism, it helped promote such neomercantilist strategies — a mix of import substitution and export-oriented industrialization. American cold warriors also gave their strategic allies unhindered access to U.S. markets while tolerating the closure of their own to American investment. By the time the United States realized that its biggest Asian ward had grown too big, it was too late. Japan had taken many products invented in the United States (automobiles, consumer electronics) and manufactured them more cheaply and with superior quality. By the 1980s, Japan had supplanted the United States in aid and investments in East Asia. When the United States sought to limit Japanese exports, the Japanese responded by deepening their investment in Asia, moving factories and improving industrial skills and technology wherever they went.

In 1994, when I first left India to travel to Southeast Asia, I found Japan everywhere, as both promise and rebuke. The renovation of Thailand, South Korea and Taiwan under Japanese auspices was then an established fact — and a standing reproach for us in India, which had failed to match East Asia's success in manufacturing and trade. Like most countries in the world after 1945, France as much as Japan, India embraced a model of state-led development. Its aim, as in many nations liberated from colonial rule, was not so much the growth of private wealth as the strengthening of national power. Friedman described Indians in "Free to Choose" as deluded followers of Mahatma Gandhi, idly spinning cotton in cottage industries subsidized by the state. India, he said, was blind to industrialization and, furthermore, believed in central planning. This was a caricature: India had an ambitious industrialization program, and its economy mixed private markets with state-owned enterprises, even if its historical experience of British rule predisposed it to suspect that free trade benefited only developed industrial economies. Nevertheless, Friedman was broadly right in his view of India as a social and economic laggard.

India, following a model of import-substitution growth, barely participated in world trade. Its factories produced shoddy goods that you bought only because there were no alternatives. And so I was dazzled by what was on offer in Southeast Asia. The emblems of pop American culture — Kentucky Fried Chicken, McDonald's, Madonna — were everywhere. But the most seductive consumer goods were almost invariably Japanese: Sony, Sanyo, National, Mitsubishi, Hitachi, Fuji.

Feeling inadequate before East Asia's progress, many middle-class Indians longed for what Chalmers Johnson, in a book about Japan's unique growth, called the "capitalist developmental state." In such states, skilled bureaucracies led by authoritarian leaders promoted a project of national development (while either paying lip service to, or ignoring, democratic norms). Private entrepreneurs made socially beneficial investments; government policies helped build their comparative advantage while also facilitating social stability with land reforms, education and other efforts to address income equality.

The “developmental state” assumed that market failures were to be expected and that the state played a necessary role in designing industrial and financial policy. These included not only trade protection and government subsidies but also, as the political economists Robert and Jean M. Gilpin wrote in “Global Political Economy” in 2003, “selective credit allocation and deliberate distortion of interest rates in order to channel cheap credit to favored economic sectors.” Governments were, in fact, very much part of the solution, as even the World Bank, beholden to the Washington Consensus, grudgingly acknowledged in its well-known 1993 report, “East Asian Miracle.” The high-performing Asian economies, it noted, “have achieved unusually low and declining levels of inequality, contrary to historical experience and contemporary evidence in other regions.”

The hero of many middle-class Indians was the authoritarian leader of Singapore, Lee Kuan Yew, whose success in turning Singapore from an economic backwater into one of the world’s major commercial cities was much admired by Deng Xiaoping. We might have also revered, had we known more about him, South Korea’s technocratic despot Park Chung-hee, who accomplished economic goals with the help of highly trained managers, and who also appeared to reduce inequality and build what we in India sorely lacked: social cohesion.

But little did I know that Hamilton (and List) would achieve their greatest influence in post-Mao China. “The rise of China resembles that of the United States a century ago,” the Chinese scholar Hu Angang writes. He is not exaggerating. Friedman may have been right that the Chinese Communists were hopelessly ignorant of how free markets work, but ending state intervention in the economy was never on the agenda. After Mao, Chinese leaders looked to Japanese and other East Asian developers, just as the East Asians had once looked to Germany.

The first investments in China in the 1980s came from Japan as well as from transnational Chinese business networks based in East Asia. China benefited from the market networks, management and technical know-how that accompanied these investments. Encouraged by the Clinton administration, it entered the World Trade Organization in 2001 and quickly seized the opportunity — limitless export markets — opened by American insistence on free trade.

Once Japan became the leading investor in Asia, regional production chains began to link those countries with one another. As Korea, Hong Kong, Singapore and Taiwan moved up the technology and value chains, they invested in developing countries, like Vietnam and Indonesia. This process of regionalizing investment and production, which largely dispenses with Europe and America, has now been accelerated by China’s rise as a manufacturing power. The biggest investor in Vietnam today, for instance, is South Korea, whose biggest trading partner is China.

The success of China’s state-led economy presents, in many ways, the same economic (and ideological) quandary that Japan unexpectedly threw up before the United States when, in the 1980s, it became the world’s leading creditor. A regional trading system dominated by China will make Asian countries less likely to enlist in American geopolitical objectives. Locked into boundary disputes with its neighbors, China has accelerated the militarization of the South China Sea, acquiring more than 3,200 acres of land on reefs and outcrops and installing runways, ports and hangars. But it has also abandoned its abrasive attitude, making determined efforts to pivot Asia away from Trump’s America. And it seems to be succeeding.

With China offering generous infrastructure deals to the former American territory of the Philippines, President Rodrigo Duterte announced that “it is time to say goodbye” to the United States — previously he threatened to ride a jet ski to a Chinese man-made island in the South China Sea and plant his country’s flag there. Other rival claimants to parts of the South China Sea — Malaysia, Vietnam and Brunei — have also moved closer to Beijing since Trump’s election. Smaller countries like Cambodia and Laos now resemble Chinese client-states. China is also trying to repair long-strained relations with Japan by inviting investments by Japanese multinationals.

These attempts to win over major American allies in Asia complement Xi’s ambitious One Belt, One Road initiative, which aims to put China at the center of global affairs through a network of trade links and infrastructure projects stretching from Asia to the Middle East to Africa and Europe. Investing more than $1 trillion in more than 60 countries — ports in Pakistan and Sri Lanka, high-speed railways in East Africa, gas pipelines in Central Asia — the initiative can claim to be the largest overseas investment drive ever undertaken by a single country. The 11 European Union members and five non-E.U. Central and Eastern European countries that have joined the China-led political and commercial group called 16+1 have all signed major infrastructure deals with China, enhancing Beijing’s influence in the E.U. The remaining 11 members of the Trans-Pacific Partnership have gone ahead without the United States; they are expected to sign a final agreement in March.

By pulling out of the TPP and threatening trade sanctions, Trump encouraged Japan to seek a deal with Europe that shuts out the United States. Britain, another stalwart American ally, is considering joining the TPP. China, meanwhile, is hectically negotiating more than a dozen trade agreements in Asia while proposing its own alternative to the TPP, a trade agreement called the Regional Comprehensive Economic Partnership. China has also intensified efforts to build alternatives to such Western international institutions as the World Bank and the International Monetary Fund. In 2014, China inaugurated, against staunch American opposition, the Asian Infrastructure Investment Bank, whose members now include all Asian states except Japan.

There is little doubt that Beijing is presenting itself as a benign alternative to the United States. In a speech just before his second term as the party's general secretary, Xi claimed that there were more takers internationally for Chinese "values." China, he said, offers "a new option for other countries and nations who want to speed up their development while preserving their independence."

It was always wildly optimistic to suppose that China would eventually be integrated into an American-dominated order and persuaded, if not forced, to adopt its norms. A postcolonial Indian like myself, who traveled to China and read in its modern history and literature over the last decade and half, could only be skeptical of such claims. It was never less than clear to me, whether in the suburbs of Lhasa, Tibet (demographically altered by Han immigration), or in the bookstores of Shanghai (stacked with best sellers with titles like "China Can Say No"), that the quest for national sovereignty and regained strength defines China's party state and its economic policies.

Belying predictions of doom, China has again demonstrated the power of what Dower, speaking of Japan, called "national pride — acute, wounded, wedded to a profound sense of vulnerability." The United States never knew this single-minded ambition of the historical loser to avenge his losses; American leaders now reckon with it at home, in the wake of a nationalistic backlash against free trade and globalization. Some confused policies and mixed signals have accordingly defined the American position on China. During the American presidential campaign in 2016, all the main candidates, Bernie Sanders and Hillary Clinton as well as Trump, opposed the TPP, which was intended to contain China in its own region. Then, in Trump's chaotic first year, the United States seemed to be forced back by Hamilton's shrewd East Asian disciples into its historical role as the mother country of protectionism. Trump now says that America first does not mean America alone, and he is open to rejoining the TPP. There may be more such reversals ahead. For Trump is only just beginning to acknowledge, after a year of bluster, the formidable challenge of China and the arduous effort needed for the United States to match its most determined and resourceful rival yet.

Photo illustration by Tamara Shopsin.

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The New York Times

Business/Financial Desk; SECTB
Everybody Take a Breath

By LANDON THOMAS Jr.
1,022 words
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English

As stocks maintained their smooth and steady climb in recent years, few trades were as alluring, or as profitable, as a bet that **volatility** as measured by Wall Street's so-called fear gauge had vanished.

Hedge fund titans in their Manhattan offices and day traders in their living rooms have poured billions of dollars into opaque, debt-fueled funds known as exchange-traded notes, racier versions of the exchange-traded funds that track every variety of index or investment and can be bought and sold just like a stock.

Now stocks are swinging wildly and **volatility** is soaring -- and investors who piled into these funds, confident that the calm would continue, are getting rattled. On Tuesday, Credit Suisse, the sponsor of the most popular fund for making such bets, said it was closing down the fund.

Credit Suisse closed the fund -- informally called XIV, which moves in the opposite direction of the fear gauge, known as VIX -- after it experienced a fall of greater than 80 percent, a price drop that left XIV trading at a deep discount relative to the value of its assets.

It had been an extraordinary ride for XIV, formally known as the Velocity Shares Daily Inverse VIX Short Term ETN. It was one of a number of funds tied to VIX, known officially as the Chicago Board Options Exchange**Volatility** Index, some of which move in the same direction, tracking the index up or down.

VIX, which measures investor expectations that stocks will rise or fall sharply in the future, has been at extreme lows in recent years, making XIV very attractive to investors and pushing it to $1.8 billion in size. Just last Wednesday, it took in a record $500 million, as investors stuck even more firmly to their belief that **volatility** was not a concern.

In the two years from January 2016 to the middle of last month, XIV's value shot up more than 500 percent, reaching a recent peak of $134.

After VIX surged on Monday, XIV dropped like a rock, falling from $99 to $7 in after-hours trading.

In just two days, investors in XIV and a similar fund, ProShares Short VIX Short Term Futures (SVXY), saw their assets shrink dramatically, from a combined total of $3 billion to about $150 million.

''People are scared out of their minds -- they are in really rough shape,'' said Seth Golden, who left his job as a manager at a Target store to take up shorting VIX as a full-time business from his living room in Ocala, Fla.

Profiled in The New York Times last summer, Mr. Golden exemplifies, perhaps in a cautionary way, how easy it has become to gamble on whether **volatility** in the **stock market** will be high or low.

He has been able to do so because investment banks have created more than 30 high-risk, high-return securities that allow any investor to bet against VIX. Some of the products require large amounts of leverage, debt that can amplify gains and losses.

Mr. Golden's preferred vehicles are the iPath **S&P 500** VIX Short Term Futures and ProShares Ultra VIX Short-Term Futures, which he has been betting against for years in trades that have been lucrative -- until now.

After VIX shot up 100 percent, the largest move in its history, to 35.73 on Monday, Mr. Golden acknowledged that he was feeling some pain. On Tuesday, the index spiked again, reaching 50 before falling back to just below 30.

"It is really stressful," he said. "I was up until the wee hours, checking my phone to see where VIX futures were trading."

Nonetheless, he said on Tuesday that he was still wagering 21 percent of his portfolio, or $600,000, that **volatility** would fall as it had in the past.

That Mr. Golden and others like him are getting hurt on these risky, niche trades should not, in theory, have a wider effect on the market. While investments in these funds have been substantial recently, their combined value is just $4 billion, a blip in a market worth trillions of dollars.

But **volatility** specialists have warned for years that the popularity of the investments has skewed the broader VIX index, keeping it artificially low in good times and pushing it higher than it should go in times of stress.

That was the case on Monday, bankers and traders said, when XIV collapsed as VIX soared in late-afternoon trading. That was because as XIV and SVXY plummeted, traders were forced to scoop up hundreds of millions of dollars in VIX futures to cover the short positions they had on the index. That drove it higher and prompted computerized trading systems to sell stocks and bonds by the truckload.

"These products definitely had an impact on the VIX," said Pravit Chintawongvanich, the head of derivatives strategy at Macro Risk Advisors. "And that exacerbated the decline in stocks. It was a vicious circle."

Some investors have taken the other side of this trade, betting that the low levels of **volatility** were distorted and that the index was likely to spike soon. When that happens, watch out, these people warned, as they estimated that $2 trillion in investor money had been directly or indirectly wagered on the markets remaining quiet.

"This is just an appetizer for what has yet to come," said Chris Cole of Artemis Capital, a hedge fund for investors who believe in such an outcome. "The world won't end tomorrow, but there has been such a massive bet on stability and low **volatility** that this could lead to a multiyear unwind."

1:52 P.M. S.&P.: 2,636.29; 2:13 P.M. S.&P.: 2,637.18 (B4); 8:27 A.M. S.&P.: 2,648.94; 3:38 P.M. S.&P.: 2,679.25; 4:02 P.M. S.&P.: 2,695.14 (B4-B5); 9:14 A.M. S.&P.: 2,648.94 (PHOTOGRAPHS BY SAM HODGSON FOR THE NEW YORK TIMES) (B5) CHART (Source: Reuters)

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The New York Times

Business/Financial Desk; SECTB
Tune Out the Noise Of the Market Slide. The Economy Is Fine.

By NEIL IRWIN
930 words
7 February 2018
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1
English

What is the stock market telling us with its precipitous drop over the last several days? In all likelihood, not much of anything.

That's because the stock market, though crucial in the long run for individuals accumulating wealth and companies raising capital, is so erratic as to be useless in providing information about the short run. The 8.5 percent drop in the S.&P. 500 through Monday's close (before a 1.7 percent rebound on Tuesday) could signify the onset of a global recession. But it could just as well mean only that some trading algorithms at a big hedge fund collided in weird ways.

For what really matters -- the well-being of the economy and the ability for individuals and companies to prosper in the years ahead -- look first to fundamental economic data, especially those that tend to be leading indicators. Second, look to the bond market and other financial market indicators that are more reliable measures of investors' expectations than stock prices.

There is good news on both fronts, as both point to a global economy that will continue growing steadily in the months and years ahead, perhaps with inflation that is a bit higher than in the recent past. That contrasts this market sell-off with drops in 2011, 2015 and 2016, which coincided with pessimistic signals in both economic data and the bond market.

The stock market can, when looked at in concert with these other indicators, provide some useful insight. Right now it appears to be more noise than signal.

The economic data has been solid in recent weeks. Just Friday, the Labor Department reported that the United States added a robust 200,000 jobs in January. The Federal Reserve Bank of Atlanta tracks incoming economic data to estimate current growth of gross domestic product, and its indicator is pointing toward robust economic expansion -- a 4 percent annual rate.

Of course, there is plenty of statistical error built into those numbers, and they may turn out to be incorrect. But even many of the real-time indicators that tend to work as early warnings of an economic slump are looking just fine. The Conference Board's index of leading economic indicators ticked up in its most recent release, and weekly claims for unemployment insurance benefits have hovered near record lows in recent weeks.

Just Monday, the Institute for Supply Management said its index of activity at service companies rose sharply in January, which made it one of those curious days when good economic news coincided with a steep market sell-off.

The bond market is also looking optimistic about the future, with prices suggesting that continued growth -- without inflationary overheating -- is the most likely future.

The stock market has lost ground since the start of the year, thanks to the sharp sell-off Monday. But the yield on 10-year Treasury bonds is up in that span, from 2.4 percent to 2.8 percent at Tuesday's close. That suggests bond investors think that continued steady recovery will allow the Federal Reserve to raise interest rates gradually.

Bond investors are pricing in higher inflation than the United States has experienced in recent years, but roughly in line with the 2 percent the Federal Reserve aims for. Prices for inflation-protected bonds imply 2.09 percent annual inflation over the coming decade, up from 1.98 percent at the start of the year.

Other market indicators that might signal global economic troubles, like the price of oil, instead point to a steady-as-she-goes global economy.

None of this makes a case for economic complacency. There are plenty of things that could go wrong in the world, from conflict on the Korean Peninsula or in the Middle East to destructive trade wars. But if the **stock market** was actually giving us any insight into the likelihood of those outcomes, we would expect to see moves in bond and commodity markets that just aren't happening.

Think of it this way. The economy is like a horse race -- and what we really care about is which horse wins, places or shows. The bond market is the equivalent of the people betting directly on the race. And while of course gamblers get it wrong sometimes, the market is efficient enough that there's a fairly direct relationship between the odds a horse pays and its probability of victory.

The **stock market**, by contrast, is like a weird side game in which people bet one another on which gambler is going to have the best day. It's erratic, **volatile** and a couple of degrees removed from the underlying horse race on which it is all based.

And that's why the best way to make sense of the drop in the **stock market** is to think of it as a sideshow to the broader trajectory of the United States and global economy, which for now look perfectly fine.

1:52 P.M. S.&P.: 2,636.29; 2:13 P.M. S.&P.: 2,637.18 (B4); 8:27 A.M. S.&P.: 2,648.94; 3:38 P.M. S.&P.: 2,679.25; 4:02 P.M. S.&P.: 2,695.14 (B4-B5); 9:14 A.M. S.&P.: 2,648.94 (PHOTOGRAPHS BY SAM HODGSON FOR THE NEW YORK TIMES) (B5) CHART: Market **Volatility**: The Chicago Board Options Exchange **Volatility** Index, known informally as the VIX, through Tuesday. (Source: FactSet)

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The New York Times

National Desk; SECTA
World Is Bracing as Era Of Easy Money Is Ending

By PETER S. GOODMAN
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English

Mere days ago, in what feels like a different era now, the biggest thing that people in control of money appeared to fear was complacency. Stock markets in the United States were surging, enthralled by the regulation-slashing, tax-shrinking predilections of President Trump. Every major economy in the world was expanding.

The worst that could happen, the money masters averred, was that investors would be lulled into reckless investments, taking on too much risk in the belief that the dangers of the marketplace had been tamed.

As it turns out, the dangers were already at work. A decade-long era of easy access to money engineered by central banks in Asia, Europe and the United States was ending, opening a new chapter in which corporations would have to pay more to borrow and ordinary people would have to pay more to finance homes, cars and other purchases.

To digest the wild swings in stocks and bonds from New York to London to Tokyo is to absorb this uncomfortable realization taking hold.

Investors concluded that interest rates would rise faster than they had anticipated, almost certainly in the United States, and perhaps eventually in Europe and Asia, too. They yanked their treasure out of stocks and entrusted it to safer repositories of wealth like bonds and cash.

A wave of selling commenced in New York on Friday, continued in Asia and Europe on Monday, and then completed its trans-global journey with a sharp drop where it had all started. While a global rout continued into Tuesday, anxiety subsided in the United States, with the **Standard & Poor**'**s 500**-**stockindex** up 1.7 percent at the close. The gains helped erase some of the losses over the past week, although the **S**.**&P**. **500** is still more than 6 percent off its peak in late January.

No degree in finance was required to divine the lesson of the moment: Markets go down as well as up, a reality often drowned out by the euphoric celebrations to greet one record or another being shattered.

While trading in the United States was clearly the initial source of alarm, the concerns spread to everywhere that money changes hands. The American economy had swapped the frivolity of a **stock market** party for the grim trappings of a bedside vigil. The result was gloom and anxiety in every reach of the financial sphere.

''The United States is by some distance the largest market on earth,'' said Gaurav Saroliya, director of global macro strategy at Oxford Economics in London. ''Growth in the United States has a huge bearing on economies everywhere. If the largest market is selling off, that has a very powerful effect on investment sentiment. It makes people risk averse.''

The fear that seized the United States was the spawn of good times. As the feeling sank in that stock trading was governed by a surplus of exuberance, the odds increased that the Federal Reserve would dampen the festivities by lifting interest rates faster than policymakers had previously telegraphed.

Not for nothing, central banks are seen by investors as crucial yet fun-averse grown-ups charged with solemnly watching for trouble. When crises emerge, they make money available to spur commerce while keeping terror at bay. The global economic expansion underway now is in large part a product of the Fed's swiftly unleashing an overwhelming surge of credit after the start of the financial crisis in 2008, combined with the slower yet, eventually, effective torrent of cash delivered by the European Central Bank.

But when the party gets raging -- when economies accelerate and stock prices ascend to levels out of whack with fundamentals -- central bankers play killjoy, lifting interest rates to snuff out attendant dangers.

Higher rates diminish speculation that can end badly by making credit more expensive. They slow economic growth while making stocks less appealing, because corporations must pay more to keep up with their debts. Investors can make more just by keeping their holdings in cash or bonds, rather than by accepting the higher risk of stocks.

The bitter irony of the current swoon is that it was triggered by the emergence of something the world has been awaiting for years: higher wages for workers.

Even as unemployment rates have lowered drastically in Britain, Japan and the United States, companies have continued to find new ways to make more products and sell more services without paying more to their employees. This has been a major source of unhappiness among working people, and a subject of consternation among policymakers.

Then, last Friday, the latest monthly snapshot of the American labor market revealed that wages had climbed 2.9 percent in January compared with a year earlier. The tight job market was forcing employers to pay more.

This appeared to presage a strengthening of American consumer power. If more working people take home more money, they will presumably be more inclined to buy houses and cars, generating jobs in construction and at auto plants from Michigan to South Carolina. They will fill restaurants, necessitating more truck drivers to ferry the food, and more mechanics to keep the trucks running.

This same so-called virtuous cycle appeared to be amplifying global growth. More cars made in the United States would require more brake linings made in Mexico and more circuitry forged in China, using copper mined in Chile. More construction would require equipment from Germany and Japan, and more iron ore from Brazil to make steel.

This interconnectivity has been central to the anticipation that a strengthening economy in the United States would lift fortunes around the world.

But the increase in wages for American workers meant something else. It was a flashing warning to investors about potential inflation, or rising prices, which have crippled many economies. The Fed, always vigilant, wields a standard tool for snuffing out inflation if necessary: higher interest rates.

This is how a positive jobs report, presumably a sign of a strengthening American economy, wound up as the impetus for the dumping of stocks from Taipei to Toronto. It enhanced the likelihood that the Fed would raise rates faster. It prompted investors to wonder how long the European Central Bank could maintain its own ultralow rates.

In the past year, Europe has shaken off perpetual worries of a grinding decline to emerge as one of the faster-growing major economies on earth. Inflation remains weak in Europe, undergirding expectations that the central bank will be slow to take back its free money.

But if the Fed were to lift rates faster, that could prompt Europe and perhaps even Japan to follow suit. Otherwise, the United States would be in a position to capture an outsize share of global investment, as rates presumably rise on American government bonds.

All of this is playing out amid a transition in central bank leadership. At the Fed, Janet L. Yellen, the economist who was the chairwoman of the Board of Governors, on Monday completed her term and handed power to her successor, Jerome H. Powell. Mr. Powell is widely expected to continue Ms. Yellen's cautious march toward higher interest rates. Still, as a newcomer taking the tiller in the midst of extraordinary **volatility**, he is a variable.

Mario Draghi, the Italian who heads the European Central Bank, is scheduled to complete his eight-year term late next year. At the Bank of Japan, Haruhiko Kuroda's term as governor expires in April, and there is uncertainty over whether he will be reappointed.

Some economists think that the dour talk is overblown and that the stock markets are running on emotion untethered from economic reality, a narrative that gained force as markets in New York snapped back from the depths on Tuesday.

The fundamentals of the United States expansion remain intact. Rising wages should indeed give people money to spend without resorting to some newfangled credit bubble that ends tragically.

Whatever the interest rates, central banks retain trillions of dollars on their balance sheets earmarked for buying up financial assets, making credit available. And the return to higher interest rates is inevitable, a healthy turn for a world economy that can finally close the books on the global financial crisis that began a decade ago.

''We have gotten used to this low interest rate environment,'' said Robert Bergqvist, chief economist at SEB, a global investment bank based in Stockholm. ''This is not the normal situation.''

The global economic expansion has occasioned hopeful talk that the world now has multiple engines of growth, inoculating it against trouble in any single region. But the events of recent days have challenged that notion, given that a sudden deterioration of stock prices on Wall Street quickly burst into a global rout.

Sentiments are clearly a viral phenomenon. Yet the distress in global markets also underscores the fact that real economic fortunes are fused.

If General Electric, Ford and other multinational companies see their share prices brought down as borrowing costs climb, they could limit plans for expansion. The trend would be felt in diminished orders for computer chips made in Taiwan, flat-panel displays forged in South Korea and auto parts built in the Czech Republic. It could cool demand for raw materials harvested from Argentina to India to South Africa.

''Business cycles across different markets are more correlated than they have ever been,'' said Mr. Saroliya, of Oxford Economics. ''It's the global supply chain.''

A decade-long era of easy access to money engineered by central banks in Asia, Europe and the United States is ending. (PHOTOGRAPH BY BEHROUZ MEHRI/AGENCE FRANCE-PRESSE -- GETTY IMAGES) (A20)
CHART: The **S**.**&P**. **500 Index** (Source: Reuters)

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The New York Times

National Desk; SECT
What Wall Street's Ups and Downs Look Like

By SAM HODGSON
651 words
7 February 2018
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The New York Times on the Web
English

Americans have pictured the **stock market** the exact same way for generations.

Men in blue jackets scamper across a trading room floor at the New York Stock Exchange, alternatively delighted or despondent, following rises and falls of geopolitical turmoil, the specter of regulation or, perhaps, the whims of other investors.

Most trading these days does not happen on the floor of the exchange. The majority are the result of selections made by algorithms, trades executed from one machine to another.

What these images of men on the trading floor convey is the mood of Wall Street, where the action affects everything from the fortunes of corporate executives to retirement savings of middle-class families with 401(k) accounts. And on days like Monday, when the **Standard & Poor's 500**-**stockindex** and the **Dow Jonesindustrial average** both experienced historic drops, pictures of anguished traders in news stories were reminders that what goes up inevitably comes back down (if only to go back up once again).

This is what Wall Street looked like on Tuesday.

8:27 a.m.

The **S**.**&P**. **500** closed the previous night at 2648.94, and trading in Asian and European markets overnight suggest that United States markets are in for another bad day. As Wall Street comes alive, an employee walks through Federal Hall with the New York Stock Exchange reflected in the glass door.

9:14 a.m.

Some New Yorkers outside of the exchange avoid the turmoil before the markets open at 9:30 to focus on what could be an equally compelling headline: pizza.

11:56 a.m.

S.&P.: 2,643.94

Change from open: -0.28 %

This passer-by on Wall Street is in red, but the markets are not. After stocks opened down, the S.&P. found a way to reverse some of its losses. Stocks would jostle up and down for much of the first half of the day.

1:52 p.m.

S.&P.: 2,636.29

Change from open: -0.57 %

Television camera crews flood the financial district when markets become turbulent. Often their prop of choice is a newspaper declaring sharp moves in bold typeface.

2:13 p.m.

S.&.P.: 2,636.91

Change from open: -0.54 %

A broker takes a break to smoke, get lunch and check his phone.

3:38 p.m.

S.&.P.: 2,694.40

Change from open: 1.62 %

Peter Tuchman, who BuzzFeed called "The Most Photographed Trader on Wall Street," works on the floor near an area where television stations run their broadcasts.

3:39 p.m.

S.&.P.: 2,697.63

Change from open: 1.75 %

Fernando Munoz, a manager for floor operations at the N.Y.S.E., shouts to a colleague as the trading day almost ends, with stocks spectacularly up after the remarkable plunge on Monday.

3:53 p.m.

S.&.P.: 2,689.22

Change from open: 1.43 %

Mark Tarr, president and chief executive of Encompass Health Corporation, a health care provider, prepares to ring the closing bell. Stocks rallied to close up 567 points.

3:57 p.m.

S.&.P.: 2,693.26

Change from open: 1.58 %

CNBC broadcasts its daily markets wrap from the floor of the exchange.

4:02 p.m.

Close: 2,695.14

Change from open: 1.74 %

After the market closes, traders finish their work. The flurry of activity tends to be concentrated around the opening and closing bells.

4:09 p.m.

A tablet serving as a teleprompter sums up the day: a "roller-coaster ride."

4:10 p.m.

At the end of the day, traders hang their ties up at their work stations, a sign of a job well done. They'll be back on the roller coaster on Wednesday, at 9:30 a.m. sharp.

Document NYTF000020180207ee270006r

Business/Financial Desk; SECT
The Times Answers Your Questions About the Market Turmoil

By TARA SIEGEL BERNARD
1,514 words
7 February 2018
The New York Times
NYTF
The New York Times on the Web
English

The stock markets have taken investors for a wild ride over the past week, with jitters in the United States spreading around the world. When the markets behave erratically, anxieties escalate and questions naturally arise.

Is now the time to invest? What should I do with my 401(k)? I'm about to retire -- what does this mean for me?

Below, we answered several of the most common questions from our readers. The questions have been edited and condensed for clarity. If you'd like us to address any others, please write to us using the form at the bottom of the piece.

What is the likelihood that this will be seen as a good opportunity to buy since basic economic indicators remain positive? -- A reader in New York

Would you say it is time to buy and, if so, when and in which world markets? -- A reader in Goa, India

Not even the billionaire investor Warren Buffett could tell us with any sort of precision whether this was the right time to buy. But market dips can be a good time to start investing, as long as you are allocating your money in a prudent way that will help you achieve your long-term goals.

To start, it helps to define those goals.

Are you investing money that you want to grow to pay for your child's college -- five years from now? Eighteen years from now? Or for your retirement?

The time frame makes a difference because many financial planners don't recommend investing money in stocks if you will need that money imminently, or generally within five years.

If you aren't comfortable plunking all of your money in the **stock market** at once, consider investing on a consistent schedule over time. Investing at regular intervals allows you to automatically take advantage of dips in the market.

Going over all of this with a trusted financial planner -- one who pledges to act in your best interest -- can be a wise investment. As my colleague Ron Lieber wrote in his column last week, there has never been a better time to hire help, even if it's just to help you come up with a plan that you want to do on your own.

I have 35 percent of my defined contribution plan invested in a United States **stock market** fund, 25 percent in a Canadian stock fund, 20 percent in an international stock fund and 20 percent in a money-market fund. I'm 15 years from retirement. Is this the right mix? -- A reader in Canada

There are no right answers here -- but there is probably a strategy that is right for you and your unique circumstances. Generally speaking, how you choose to allocate your investments among stock, bonds and cash should be in keeping with your overall goals, age, time horizon and stomach for risk. A diversified portfolio of inexpensive stock and bond funds, both domestic and international, is typically a good place to start.

Precisely how you divvy it all up is a highly personal decision. Consider this thought exercise when thinking about how much you want to invest in stocks.

Figure out the total amount you have invested in the **stock market** now (as opposed to money in bonds in cash). Then think about what you would do if that pot of money lost 10 percent of its value. What about 20 percent? Would you be willing to sit tight and remain invested?

If the answer is "no," you may be invested too aggressively.

On the other hand, if you expect to live another quarter-century in retirement, you want your money to grow enough to at least keep pace with inflation.

If you want to see how your current allocation compares with what a professional might choose, you can also look under the hood of a target-date fund -- a mutual fund whose mix of stock and bond investments gets more conservative as it approaches a target retirement date.

In your case, that would be somewhere between 2030 and 2035. (Just keep in mind that some of these funds are more aggressive than others. So look at funds from, say, Vanguard, Fidelity and others to get a better feel for how they vary.)

How does it affect the housing market? -- A reader in Grover Beach, Calif.

The **stock market**'s gyrations are not likely to have a tangible effect on the housing market -- at least not right now, according to Mark Zandi, chief economist of Moody's Analytics.

If the market's overall slump is limited to the roughly 10 percent decline from its peak, Mr. Zandi doesn't expect any changes. Stock prices are just back to where they were at the start of 2018. But a more significant **stock market** drop could change the sentiment toward the housing market. As people's savings and investments decline, they often become less willing to buy a home.

"If stock prices keep dropping, say 20 percent, and stay down, then it will sap the energy from the housing market, particularly at the higher end of the market," Mr. Zandi said. He added that shoppers for higher-end homes are already trying to digest the changes that came with the new tax legislation, which, for example, limits the deduction on mortgage interest. A meaningful market dive could also dampen enthusiasm within the vacation home market.

"So no big deal so far," he added, "but the script is still being written."

Should I shift my 401(k) portfolio to bonds right now to stop taking major **stock market** losses? -- A reader in Santa Cruz, Calif.

Is the best long-term strategy to just hang in there? -- A reader in Potomac, Md.

Trying to time the market is a bad idea because you have to get two things right.

First, you need to know the right time to sell your stock investments, ideally when they're flying high. Then, you need to divine the best time to reinvest your money.

Even the most experienced stock-picking professionals rarely get it right -- at least consistently and for long periods of time. That is why buying a collection of diversified index funds and holding them is the best strategy for most investors.

Look at what happened on Monday. If investors sold their stock funds when the market was dropping, that may have felt like the right thing to do in the moment. But if those investors regretted their decision and tried to reinvest on Tuesday -- when stocks started to stage a recovery -- they would have locked in their losses.

A retired couple I wrote about in 2012, and who suffered significant losses during the market plunge of 2008 and 2009, provides a good example. The couple's retirement portfolio, which was evenly divided between stocks and bonds, lost 25 of its value from the market peak preceding the drop in 2008 and 2009. But the portfolio recovered within a few years.

I'm planning to retire in three years. I moved 95 percent of my holdings to stable bonds two years ago. What is the outlook for the bond market? -- A reader in New York

It's hard to make any sort of prediction for the bond market over all. But investors tend to get nervous when interest rates tick higher and **bond prices** usually fall in response. Existing bonds become less valuable because investors can buy a new one with a higher coupon.

To get a sense of how your own bond funds may react to rising rates, take a look at their duration. The duration generally measures how long it will take to receive all of your money back, on average, from interest and your original investment.

If interest rates rose a full percentage point, a fund like the Vanguard Total Bond Market Index Fund, which has an average duration of 6.1 years, would decline by about 6.1 percent. But since the fund also pays investors income, it would post a total loss of roughly only 3.0 percent. And the yield would eventually increase, helping to mitigate the loss.

For this reason, some investors tend to favor shorter-duration bond investments when rates are on the rise. Such investments are less sensitive to interest rate fluctuations.

Regardless of where rates are headed, bonds serve as an important ballast to stocks in investors' portfolios. And high-quality bonds -- including those issued by federal, state or local governments, government agencies or healthy companies -- tend to perform better than lower-quality bonds during times of **stock market** turmoil.

"Higher-quality bonds have tended to hold up better in **equity market** sell-offs," said Fran Kinniry, a principal in Vanguard's Investment Strategy Group. "This was true again yesterday, with high-quality outperforming low-quality bonds." On Monday, he said, those **bond prices** rose 0.20 percent to 0.60 percent.

"A stay-the-course message on bonds," Mr. Kinniry added, "is extremely prudent."

Document NYTF000020180207ee270005u

The New York Times

ECONOMIC SCENE
Business/Financial Desk; SECTB
What to Worry About: Decrease in Start-Ups Is a Sign of Stagnation

By EDUARDO PORTER
1,170 words
7 February 2018
The New York Times
NYTF
Late Edition - Final
1
English

Can the market economy still deliver prosperity?

That may seem an odd question to ask when the United States is more than eight years into a sustained expansion and the world's major economies are finally following suit. Unemployment is at its lowest since the end of the dot-com bubble at the end of the Clinton administration. The **stock market**'s sugar high, fueled by juicy profits and falling taxes, is being tempered only somewhat by fear that the Federal Reserve will take the punch bowl away.

And yet a broad sweep of statistics reveals a peculiar weariness spreading through the economy. Belying breathless headlines about the fabulous opportunities that technology is about to bestow on society, it suggests that many rich market democracies have lost much of their dynamism. Their companies are getting old, and their labor markets are getting stuck. Productivity growth has slumped. And many workers in their prime are peeling off from the labor force.

The pattern is particularly striking in the United States, where the share of adults with a job remains well below its peak at the end of the 20th century, and productivity growth has trundled along over the last decade at the slowest pace since the end of World War II.

But signs of lethargy are showing up elsewhere in the industrialized world. Productivity is at a crawl in most rich economies. Though not as intensely as in the United States, men in their prime, 25 to 54 years old, are leaving the labor force across the nations of the Organization for Economic Cooperation and Development. While women have picked up some of the slack, the labor supply across the O.E.C.D. as a whole has flattened.

Most notably, the economy's ability to generate and support new businesses -- agents of creative destruction that bring new products and methods into the marketplace -- appears to be faltering across the world. In the United States, the rate of company formation is half what it was four decades ago. And it is slowing in many industrialized countries.

One might blame this on the recession that crippled the world almost a decade ago, in the wake of the global financial crisis set off by the implosion of home values in the United States. But the weariness extends beyond the latest turns of the economic cycle.

The stagnation poses a threat to the market economy's main claim to legitimacy: that it delivers prosperity. The income of the typical American household is roughly the same as it was in the 1980s. It is unlikely to be a coincidence.

In a study published on Tuesday by the Hamilton Project at the Brookings Institution, Jay Shambaugh, Ryan Nunn and Patrick Liu explore what economists have figured out about the American economy's inertia and the fallout for wages and living standards.

The evidence paints a distinct picture of decline: Fewer start-ups mean fewer new ideas and fewer young, productive businesses to replace older, less productive ones. Researchers have found that the decline in companies entering the market since 1980 has trimmed productivity growth by about 3.1 percent.

The dearth of new businesses is also cutting off one of the main paths to workers' advancement: the outside job offer. Changing jobs allows workers to shift to positions in which they are more productive, and better paid. But labor market fluidity -- job switching, creation and destruction -- has been declining since the 1980s.

Clear though the pattern may be, the researchers acknowledge that we haven't yet figured out what is holding the economy's dynamism back. ''This is one of those big, economywide trends,'' Mr. Shambaugh told me. ''There is room for a lot of stories.''

Can the corporate landscape become more dynamic again? ''None of the potential policy explanations have been conclusively shown to account for the bulk of the decline in dynamism,'' Mr. Shambaugh and his colleagues note. The critical question that remains is whether there is a set of policies that might restore the economy's vitality.

This isn't just about demographic and social change. Sure, we are aging. Older workers will be less likely to move to a new job across state lines. Families with two earners will have a harder time relocating when one gets a new job offer. Stratospheric rents will make it tough to migrate to some of the most vibrant labor markets, like New York or San Francisco.

Policy has certainly played a role: Labor market regulations can gum up the sorting of workers into the best possible jobs, where they will be at their most productive and most highly paid. Specifically, state occupational licensing rules fence off some of the most desirable, well-paid jobs.

But this alone cannot explain away stagnation. Explaining stagnation requires explaining not only why there are so few well-paying jobs but also why there are so few emergent companies ready to employ productive workers. Well into the information age, in a business ecosystem with low barriers to entry, where venture capital stands ready to throw itself at the next good idea, the economy has somehow forgotten how to create companies.

My best guess is that this is all about the decline of competition. Mr. Shambaugh and his co-authors note how noncompete agreements and other devices used by businesses to stop their employees from seeking jobs elsewhere are preventing many workers from taking the better job that pays more money. I would argue that the failure is bigger: By allowing an ecosystem of gargantuan companies to develop, all but dominating the markets they served, the American economy shut out disruption. And thus it shut out change.

This is not the only possible diagnosis, I understand. Many economists will reject my proposition that the nation's economy has been given to oligopolies; that antitrust law has proved no match for the ferocious concentration of market power in the hands of a few businesses that have been allowed to impose their will on the economy as a whole.

It fits, however. An economy controlled by big, entrenched companies will have little place for the kind of disruption that could push productivity onto a higher plane. That description looks very much like the economy that many American workers are coping with today.

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1:52 P.M. S.&P.: 2,636.29; 2:13 P.M. S.&P.: 2,637.18 (B4); 8:27 A.M. S.&P.: 2,648.94; 3:38 P.M. S.&P.: 2,679.25; 4:02 P.M. S.&P.: 2,695.14 (B4-B5); 9:14 A.M. S.&P.: 2,648.94 (PHOTOGRAPHS BY SAM HODGSON FOR THE NEW YORK TIMES) (B5) CHART: Interest Rates Suggest an Improving Outlook: The bond market is not flashing warnings of economic weakness, even amid the **stock market** downturn. (Source: Treasury Department)

Document NYTF000020180207ee270005s

The New York Times

Business/Financial Desk; SECT
Wall Street Halts a Global Rout

By MATT PHILLIPS; Jack Ewing, Alexandra Stevenson and Alan Rappeport contributed reporting.
663 words
7 February 2018
The New York Times
NYTF
The New York Times on the Web
English

After days of sometimes wild moves in stock markets, Wall Street had a good day on Tuesday. Investors refocused on the continuing strength of the American economy as shares of consumer companies helped lead broad indexes higher.

A panicky global market sell-off -- begun Monday when the **Standard & Poor's 500-stockindex** lost more than 4 percent, its worst decline since August 2011 -- dissipated on Tuesday, and the **S.&P. 500** ended the session up by about 1.7 percent. The **Dow Jonesindustrial average** gained about 2.3 percent.

The consumer discretionary sector of the **S.&P. 500** jumped by more than 2 percent, pulled higher by strength in well-known consumer-facing companies like Amazon, Netflix and Home Depot. General Motors also rose after reporting strong earnings and strong demand for its pickup trucks and sport-utility vehicles.

The decline in stock markets on Monday was steep, but not the worst one-day percentage drop in the **S.&P. 500**. In the history of the index, 38 one-day drops were worse.

For months, markets seemed to sleepwalk ever higher, as measures of **volatility** -- the ups and downs of stock prices -- hit remarkably calm levels. Investors appeared to grow accustomed to an economic backdrop of lackluster growth and inflation, a state of affairs that ensured powerful global central banks would continue to support markets with a range of policies.

But that peaceful climb ended in recent days. Investors have become worried that the solid economy in the United States could be showing early signals of inflationary pressure and that the Federal Reserve could raise interest rates more quickly than previously expected. Those concerns drove yields on long-term Treasury bonds sharply higher in recent weeks, as economic data -- such as the Labor Department's jobs report on Friday -- showed wages growing at their fastest clip in years.

Before long, there was concern that stock values had peaked, that a long-awaited correction was underway and that investors would suffer even bigger losses if they waited too long to dump their holdings. The result was Monday's sell-off. (See how Monday's plunge compares with previous bad days on Wall Street.)

But Tuesday's results put a brake to the slide, at least for now.

While President Trump has regularly pointed to increasing share prices as a sign of a strengthening economy, Vice President Mike Pence on Tuesday largely dismissed the latest falls as simply "the ebb and flow" of stock markets. Mr. Pence, who was speaking to reporters as he headed to Asia, said the United States economy remained strong, pointing in particular to record-low unemployment and signs of accelerating wage growth. (Here's a look at how Mr. Trump has tied his political fortunes to the **stock market**.)

The Treasury secretary, Steven Mnuchin, said it was possible that algorithmic trading programs were partly responsible for recent **volatility** in the **stock market**. "I have heard from others that it has played a role -- as there's more programmed trading, this tends to have **volatility** in both directions," he said Tuesday, adding that market participants are acting in an orderly fashion and that there are no liquidity problems.

In a sign of investor confidence, yields on the **10-year Treasury** note rose on Tuesday. Spooked investors had bought supersafe government bonds in recent days after being startled by the market sell-off, bringing yields lower. So, the rise in yields suggests investors are regaining their nerve.

(The Upshot looks at economic data that paint a more optimistic picture than the **stock market**.)

But pockets of **volatility** remain. A measure of expected market turbulence, the CBOE**Volatility** Index, known as the VIX, has risen sharply. It has hit its highest level since 2011, rising more than 160 percent in February alone.

Follow Matt Phillips on Twitter: @MatthewPhillips.

Document NYTF000020180207ee270004a

The New York Times

Business/Financial Desk; SECT
How Deep Is the Hole the Stock Market Just Stepped In?

By PETER EAVIS
634 words
7 February 2018
The New York Times
NYTF
The New York Times on the Web
English

Pothole or abyss?

After the **Dow Jonesindustrial average** index shed 1,175 points on Monday, extending a rout that began in earnest last week, investors will be wondering what size hole the market has just fallen into.

Of course, it's impossible to tell exactly where a bottom is, but there are ways to assess whether a sell-off will gather steam or burn out.

What started this panic?

Nearly all the economic news has been good in recent weeks, but in the often-neurotic world of investing, the news has perhaps been too good. Two reports last week that wages are growing at a solid pace, for instance, helped prompt the latest selling.

Investors fear that an increase in wages, especially at a time of low unemployment, might lead to higher inflation, which in turn could prompt the Federal Reserve to increase interest rates more quickly than expected. The higher borrowing costs would then crimp companies' investment plans, leading eventually to lower economic growth over all. There is no evidence that this chain reaction has begun, but when the **stock market** is in a skittish mood, it does not wait around for the next economic release.

What would change the market's mood ?

The market will stop sliding when investors start to see bargains and start buying in earnest. But on certain measures, stocks are still expensive.

One way to value companies on the **stock market** is to compare their share prices with their earnings. If, say, a company made a dollar per share last year and its stock trades at $20, it has a price-to-earnings multiple of 20. As the market kept rising in recent months, investors were willing to pay a high price for companies' earnings. And even after Monday's plunge, stock valuations still look demanding. At its peak in January, the **Standard & Poor's 500**-**stockindex** traded at 23 times the 2017 profits of the companies in the benchmark. That multiple was well above the average of 19 times for the past five years. If the **S**.**&P**. **500** traded at 19 times 2017 earnings, it would be 10 percent lower than Monday's closing level of 2,649.

But there is a more optimistic approach that looks at what companies will make in the future. Now, earnings expectations are **bullish**, with Wall Street analysts expecting companies in the **S**.**&P**. **500** to increase their profits by more than 20 percent. Applying a valuation of 19 times expected 2018 earnings suggests that the market has already sold off too much. But the danger with that approach is that it depends on companies actually delivering those stellar profits. And any sign of a widespread earnings disappointment could set off more selling.

Can the damage stay contained?

Steep and prolonged **stock market** sell-offs become particularly dangerous when they spread fear through other markets and weigh on the financial system and the wider economy. On that front, it is worth noting that a closely watched index of the **S**.**&P**. **500**'s **volatility**, a gauge of fear known on Wall Street as the Vix, more than doubled on Monday. Bond markets have also been hit by selling. At times like this, professional investors, especially those using borrowed money to make their bets, can report shock losses, adding to the climate of fear. And consumers, long buoyed by the rising value of their stock investments, may cut back spending.

But there are some grounds for optimism. The financial system has far more protection against losses than it had in 2008, which means it can withstand hits itself and should have the strength to keep serving clients through a rocky period.

Document NYTF000020180207ee270004c

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Mnuchin: Market Functioning Well

By Kate Davidson
493 words
7 February 2018
The Wall Street Journal
J
A2
English

WASHINGTON -- Treasury Secretary Steven Mnuchin tried Tuesday to damp concerns over the recent **stock-market** fall, which he said wasn't tied to issues of financial stability and didn't overly concern him.

"I think the fundamentals are quite strong," he told lawmakers on the House Financial Services Committee, adding, "I don't think these types of moves, given how much the market has rallied, do have financial-stability concerns."

Mr. Mnuchin, who noted that trading on Tuesday morning had been "quite **volatile**," said he checked in with market participants to make sure markets were functioning in an orderly way. "I'm happy to report that I got the green lights," he said, reiterating his earlier comments that markets appeared to be functioning "very well."

Mr. Mnuchin said algorithmic trading definitely had an impact on Monday's market turbulence, but he declined to offer any recommendations to lawmakers related to potential concerns about such trading and its impact on markets.

The secretary chalked up the recent **volatility** to a "normal market correction" that he said represented a short-term disconnect from underlying economic fundamentals, which he said were also strong. "Markets move in both directions," he said.

U.S. employers added 200,000 jobs in January and the average hourly wages for private-sector workers grew 2.9% last month from a year earlier, the Labor Department said Friday, marking the latest evidence of a tightening labor market that has been adding jobs for 88 consecutive months despite a sluggish pace of overall economic growth.

Investors saw the positive economic news, however, as evidence that the economy is heating up and inflation beginning to rise, raising the prospect of faster interest-rate increases. The **Dow Jones Industrial Average** fell sharply Friday, followed by its biggest-ever daily point plunge Monday that rippled through global **financial markets**.

Rep. Carolyn Maloney (D., N.Y.) asked whether the administration would accept blame for the recent market drop. "I think we'll still claim credit for the fact that it's up 30% since the election," Mr. Mnuchin said, referring to the **Dow Jones Industrial Average**. On Tuesday, the Dow was up 2.33%.

Separately, Mr. Mnuchin urged lawmakers again to raise the federal borrowing limit as soon as possible but declined to say whether Congress should include a debt-limit increase as part of a short-term spending bill this week to keep the government open. The Treasury has said the government has enough cash to keep paying its bills through the end of February.

The Congressional Budget Office said last week the Treasury could run out of cash in early March. That timeline is earlier than previously, in part because of the massive tax cut enacted last year, which the CBO said could reduce tax receipts by $10 billion to $15 billion a month starting this month.

Document J000000020180207ee2700027

THE WALL STREET JOURNAL.
U.S. EDITION

Oil Prices Slip on Supply, Output Worries

By Stephanie Yang and Christopher Alessi
120 words
7 February 2018
The Wall Street Journal
J
B15
English

Oil prices fell Tuesday as traders anticipated an increase in U.S. stockpiles and expanding shale production.

Light, sweet crude settled down 76 cents, or 1.2%, to $63.39 a barrel on the New York Mercantile Exchange, its lowest close since Jan. 19. Brent, the global benchmark, declined 76 cents, or 1.1%, to $66.86, a one-month low. Traders and analysts surveyed by The Wall Street Journal expect, on average, that crude stockpiles increased by 2.5 million barrels in the week ended Feb. 2. The U.S. Energy Information Administration releases the official data Wednesday.

Document J000000020180207ee270000u

THE WALL STREET JOURNAL.
U.S. EDITION

Volatility Bets Fuel The Market's Fire

By Mike Bird
336 words
7 February 2018
The Wall Street Journal
J
B14
English

The recent plunge in global stock markets has shined a light on a popular strategy among investors: shorting **volatility**.

The use of this trade has contributed to the largest fall in some U.S. stock markets since 2011.

The **Dow Jones Industrial Average** fell 4.6% Monday as the Cboe **Volatility** Index, or VIX -- a measure of U.S. **stock-market volatility** -- surged to its highest closing level in 2 1/2 years. On Tuesday, the Dow rebounded to climb 2.3%, while the VIX dropped 20%.

Shorting **volatility** means betting the VIX will remain low or fall further, often by buying an exchange-traded product that rises in value when gauges of **volatility** decline.

In a research paper published in November, Vineer Bhansali, founder of investment advisory firm LongTail Alpha, and Professor Larry Harris of the USC Marshall School of Business explained how shorting **volatility** could feed through to tank the broader **stock market**.

They warned that "the extraordinary growth of short **volatility** strategies creates risks that may trigger the next serious market crash."

The paper suggests that the growth in the use of such strategies and the correlation between them risked a big reversal as investors scramble to cover their short positions.

To cover a short position, investors who are shorting **volatility** buy back the asset they sold in the first place.

Risk parity or **volatility** target funds are a similar source of potential further sharp moves. Such funds aim to invest in assets based on their **volatility**.

When **volatility** spikes, that strategy involves selling the newly volatileunderlyingassets and rotating to more stable holdings such as cash.

Messrs. Bhansali and Harris estimated that $1.5 trillion was invested in funds with **volatility**-linked strategies, a large sum capable of shifting global markets.

"When those positions start to unwind, they unwind rapidly as everyone goes in one direction," said Paul Flood, portfolio manager at Newton Investment Management.

Document J000000020180207ee270000p

The New York Times

Editorial
Opinion
Do You Think Donald Trump Is Ready for a Real Financial Crisis?

By The Editorial Board
827 words
6 February 2018
07:31 PM
NYTimes.com Feed
NYTFEED
English

The global **financial markets** are not in crisis. Though some pundits stoked panic with their coverage of several days of market plunges before Tuesday's leap, stock prices are still near their record highs, the economy is creating jobs and many workers are finally getting decent raises after years of stagnant wages.

Which doesn't mean that there's nothing to worry about. In recent months, time after time, both the current administration and its allies in Congress have called into question their credibility and competence to manage the economy or handle a financial crisis if one were to occur. President Trump has repeatedly patted himself on the back for a surging **stock market**, seemingly unaware that stocks can go down, not just up. His Treasury Department in December released a one-page analysis that made outlandish economic assumptions to justify giant tax cuts for corporations and wealthy families. Republican lawmakers in Congress went even further, attacking the Congressional Budget Office and Congress's Joint Committee on Taxation, both nonpartisan, because those analysts had the temerity to warn that the tax law would add to the federal deficit.

Mr. Trump wants everyone to know that his election delivered a booster shot to the economy and stocks. "The reason our **stock market** is so successful is because of me," he told reporters in November. Truth is, the president was just lucky enough to have inherited a growing economy and a rising **stock market**. Though his tax cuts were an expensive gift to investors, he has not been in office long enough to have fundamentally changed that trajectory. But his erratic behavior and poor policy choices are clearly worrying the majority of Americans who disapprove of the president.

One reason some investors have become nervous recently is they fear that the tax cuts, which Mr. Trump and Republican lawmakers sold as a way to stimulate the economy, could end up hurting the economy in the not so distant future. The tax law and a push by the Trump administration to increase military spending will reduce federal revenue and force the Treasury to borrow more money when the economy is close to full employment. This could stoke inflation and prompt the Federal Reserve to tighten monetary policy. That, in turn, would slow the economy.

The prospect of a recession or financial crisis on Mr. Trump's watch is unnerving, because he is as confident in his own abilities as he is lacking in knowledge and sound judgment. When confronted with criticism, he lashes out like an intemperate child. On Monday, he said Democrats who did not applaud during his State of the Union address were un-American and treasonous. If the **stock market** falls further, will the president try to reassure the public, or will he launch a Twitter fusillade blaming the drop on, say, a conspiracy hatched by the Senate minority leader, Chuck Schumer, and Tom Steyer, the billionaire hedge fund manager who wants Mr. Trump impeached?

Many people would have been more sanguine about the Trump presidency had he surrounded himself with competent aides and advisers. Instead, he has stacked his administration with incompetent yes men, right-wing ideologues and Washington swamp dwellers. Consider the Treasury secretary, Steven Mnuchin, a former investment banker, who unnerved the currency market last month by suggesting that the United States was trying to weaken the dollar. His statement broke with the longstanding practice followed by Treasury secretaries from both parties to avoid making careless public pronouncements about American currency. Mr. Mnuchin and Gary Cohn, the White House's chief economic adviser, also debased their credibility last year by arguing with no evidence whatsoever that the Republican tax cut would pay for itself. Over in Congress, the Republican House speaker, Paul Ryan, tried to pass off as good economic news that a public school secretary would take home an extra $1.50 a week as a result of the tax law.

Then there is the harm wrought by the tax law. By greatly expanding the deficit, it will limit the federal government's ability to stimulate the economy in the future when it actually needs a jump-start. In many ways the tax law is already having a perverse effect. Mr. Ryan, for one, is citing the deficit to make the case that the government needs to slash Medicaid, Medicare and other important government programs. Other members of his party are using the deficits to argue that the government cannot afford to repair and upgrade the country's dilapidated infrastructure.

A big drop in stock prices focuses minds, especially when it comes after years of relatively steady gains. But the real crisis is in Washington, not on Wall Street.

A feed of President Trump speaking was shown live in November on the trading floor of the New York Stock Exchange. | Bryan R. Smith/Agence France-Presse — Getty Images

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THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: Wells Fargo Feels the Pinch From Fed --- Bank's stock sinks in wake of enforcement action, wiping out $29 billion in value

By Emily Glazer
870 words
6 February 2018
The Wall Street Journal
J
B10
English

A selloff in Wells Fargo & Co . shares chopped $29 billion from the bank's market value after the Federal Reserve cast it into a regulatory purgatory and limited its ability to expand its business.

Shares tumbled 9.2% on Monday amid a broader selloff in stock prices, as analysts ratcheted down earnings estimates for the third-largest U.S. bank by assets. The decline, its sharpest one-day drop since April 2009, was especially painful because the recently bright outlook for banks was also thrown into question Monday.

The acute market declines shifted, at least for now, bank investors' optimism about stronger economic growth, rising interest rates and lighter regulation. The KBW **Nasdaq** Bank Index dropped 4.9%, slightly more than the 4.6% decline in the **Dow Jones Industrial Average**.

Still, Wells Fargo has been hit the hardest. Since the start of the year, Wells Fargo 's shares have lost 4.2%, while its biggest peers have gained between 2% and 3%.

Meanwhile, the bank's price/earnings ratio has fallen below that of JPMorgan Chase & Co . and Bank of America Corp .

The challenge now facing Wells Fargo was on display Friday night in an analyst call held less than two hours after the Fed announced an unprecedented enforcement action and said the bank would replace four board directors by year-end.

Chief Executive Officer Timothy Sloan said five times on the call that the bank is "open for business."

Wells Fargo in its presentation to analysts Friday night said that it expected the Fed action to reduce 2018 after-tax profit by between $300 million and $400 million.

Such a reduction comes at an inopportune time for Wells Fargo . Over the past three quarters, the bank's net interest income -- a gauge of lending profitability -- has fallen. At the same time, the bank has been in the midst of an effort to cut $4 billion in annual costs by 2019.

In the wake of the Fed's growth cap, half a dozen analysts on Monday cut estimates for 2018 earnings per share to an average of $4.71 from a previous average of $4.83. Some of those analysts trimmed forecasts for 2019 earnings to an average of $5.16, down from an average of $5.40.

KBW bank analyst Brian Kleinhanzl downgraded Wells Fargo to "market perform" from "outperform" and lowered his earnings-per-share estimates to $4.70 from $4.90 for 2018 and to $5.10 from $5.45 for 2019.

"The bottom line is that the [Fed] order will mean Wells will have a harder time maintaining market share and will have to compete more on price or credit terms versus peers," he wrote.

Gerard Cassidy, an RBC Capital bank analyst, also voiced concerns about competition, writing that "existing customers could be pried away from the company by aggressive competitors." He added that given a positive outlook for the banking industry, investors would be better off owning JPMorgan , Bank of America or Citigroup Inc ., which "will be able to harness the growth of the U.S. economy."

Wells Fargo executives said Friday that they would use a series of financial maneuvers to limit certain activities so the bank won't have to deny business to its large consumer base. But certain commercial customers could get squeezed.

For instance, the bank may reduce certain commercial deposits known as "nonoperational," of which it had roughly $200 billion as of the end of 2017. That is a tactic JPMorgan used to lower its asset size a few years ago.

Wells Fargo may also limit financial institutions' deposits, which tallied $149 billion at year-end 2017. And it could also reduce its $92 billion in trading assets and $91 billion in short-term investments as of Dec. 31, 2017.

Some analysts were more sanguine. Sanford C. Bernstein's John McDonald wrote Monday that the growth cap will be manageable because Wells Fargo "was already planning to continue shrinking. . .auto and home-equity loans." He estimates the two noncore portfolios will decline by about $15 billion this year, "creating additional flexibility" for the bank.

Overall, Mr. McDonald said he expects the impact of the Fed moves to go away by next year. He added the growth cap hadn't significantly altered his view of the bank, but he had been modeling just 1% loan growth in 2018.

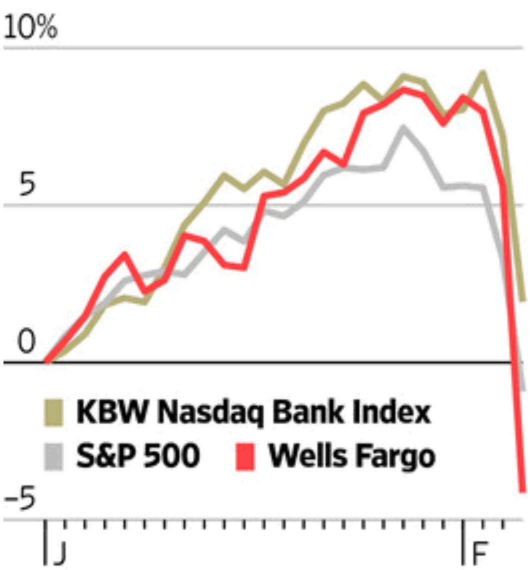
Some investors were taken aback by the Fed's action and the fact the bank hasn't fully overcome the sales-practices scandal. Still, others were holding on.

Shareholder David Katz said the Fed's action is "sending another message to Wells that they've got to be more aggressive in getting their act together." But he said he was confident in the bank's approach to how it can "meet all the needs" of clients and manage the balance sheet.

Mr. Katz, who is president and chief investment officer at New York-based Matrix Asset Advisors Inc. that owns about 480,000 Wells Fargo shares, said the firm plans to hold its current position.

Stumbling

Performance in 2018



Source: WSJ Market Data Group

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THE WALL STREET JOURNAL.
U.S. EDITION

Analysis: Latest Selloff Can End Two Ways

By James Mackintosh
839 words
6 February 2018
The Wall Street Journal
J
A1
English

Corrections & Amplifications

Since 1964, the **S&P 500** has moved in a range of 4%-5% on average about 0.3% of trading days a year, or 0.8 day a year. A graphic with a Page One article on Feb. 6 about the **stock market** incorrectly said such moves occur on average 0.2 day a year.

(WSJ Feb. 15, 2018)

(END)

Good news, it seems, is bad news again.

Payroll figures that showed more jobs and more pay for Americans sparked a market decline Friday that only got worse on Monday.

Over the past two trading days, the **S&P 500** fell by 6.1% -- the steepest such drop since August 2015, but something that has happened on average once every two years since 1964. It still came as a shock after such a long period of subdued **volatility**.

We shouldn't put too much weight on any given day's price moves, but the recent market plunge feeds two narratives, one of which could be really bad news.

Both explanations involve higher bond yields hurting stocks. But one has a brief correction followed by a happy ending for shareholders, if not for bond investors, while the other is a tale of woe for both. Either way, a lot depends on whether President Donald Trump's tax cuts will be wasted in inflation or boost the real economy.

If the **stock-market** drop of the past two days was a knee-jerk reaction to tighter credit, then the **bull market** can resume so long as the economy and corporate profits remain strong. If, however, the lesson is that, after years of calm, inflation is about to get wild, the conclusion is darker.

Precisely what we should make of the selloff that started Friday is obscured by shifts during the day. The surprisingly good headline on jobs and pay figures led traders immediately to price in a higher chance of more Federal Reserve interest-rate rises, both in futures markets and the two-year U.S. Treasury.

But as the day wore on and investors read beyond the headlines to some less positive details of the jobs report, markets retreated on their assumption of Fed rate increases. The two-year **bond yield**, sensitive to short-term Fed moves, ended Friday back below where it started, while Fed Fund futures by late Monday put a lower probability on three rate rises this year than before the jobs figures.

Meanwhile, stocks sold off without a tight link to bond yields on Friday, and fell in lockstep with yields on Monday.

Explanation No. 1 is that the initial shock of the brief fears of a hawkish Fed first hit bonds, and that was enough to startle shareholders, and the drop gathered momentum.

Such an explanation is plausible because investors were complacent. Money poured into equity funds in January, investors' cash holdings were low and almost every measure of sentiment was extremely positive.

The less investors are braced for unexpected news, the less it takes to scare them. If this explanation is right, what happens next depends on how many people are left waiting to buy the dip.

The fewer buy-the-dippers are left, the bigger the dip has to be to attract buyers. The longer-run story would be little changed, given Fed expectations are back down again, but at its worst on Monday the dip from January's high was more than 8%. That is quite a dip already.

More threatening for shareholders is the second explanation, which relies instead on **volatility**, prompted by rising uncertainty about inflation. Long-dated Treasury yields rose relentlessly from early December until the 10-year note hit 2.885% early on Monday, the highest since January 2014, before falling back.

Friday's rise in long-dated Treasury yields wasn't prompted mainly by forecasts of faster Fed rate increases. Instead, in this explanation, inflation uncertainty mattered as much or more than the actual level of inflation.

Bonds offer an extra reward, known as the term premium, above the path interest rates are likely to follow between now and maturity.

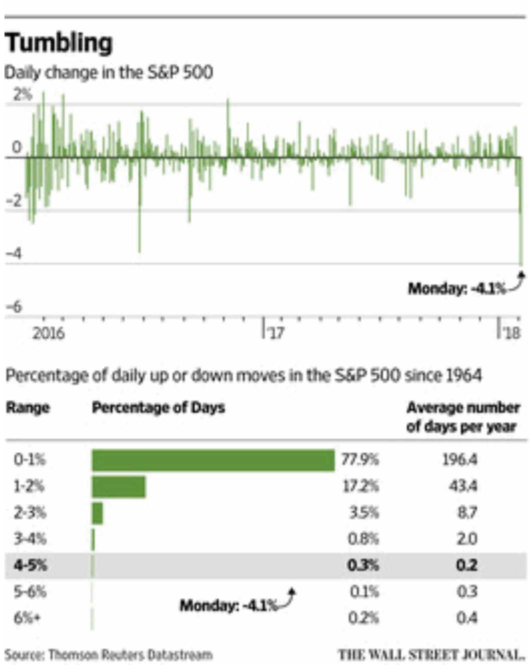
The more certain the path of rates, the lower the term premium. Since the Fed sets rates depending on inflation, the more certain investors are about inflation, the less extra yield they demand to hold bonds. Friday's jobs figures quite rightly made investors much less sure about inflation, and so they pushed up bond yields.

Rising bond yields often go hand-in-hand with rising stocks, but not this time. It all depends why yields are rising: If the economy is strengthening, the higher profits that result should balance out higher yields.

But if yields are rising because of uncertainty, future profits are unaffected and prices should fall to reflect the higher discount rate.

If investors think U.S. tax cuts will mostly stoke inflation and inequality rather than growth-enhancing capital spending and productivity, that will be bad for both bonds and stocks. If the tax cuts lead to the faster real growth promised by the White House, bonds will still suffer, but stocks should do well once the uncertainty is resolved.

The losses of the past two days gave us a foretaste of what could be an unpleasant outcome if Mr. Trump's team is wrong.



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The New York Times

Your Money
Your Money

So It's Your First Market Hiccup. What Should You Do Now?

By Ron Lieber
1,186 words
6 February 2018
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English

We've been here before. Stocks can fall fast and bounce back hard, even if they haven't moved all that much or that quickly in recent years.

But perhaps you haven't been here before. Maybe you just started investing in an individual retirement account or 401(k) at your first full-time job. Or perhaps you feared the **stock market** all through your 20s and 30s but finally got up the nerve to wade in 18 months ago.

And now, after watching the **Standard & Poor**'**s 500**-**stockindex** fall by several percentage points since Thursday and bounce some of the way back on Tuesday, you have a different kind of fear: that all the **stock market** riches have been won already or that your emotions will get the best of you amid all of the **volatility**. It's tempting to sell what you have as quickly as possible to make that feeling go away.

But before you do, take a deep breath and ask yourself these six questions.

Is the Stream of News Useful?

Watching the overall market numbers move up and down on television or the internet can be addictive. Even if your net worth is low, when the market goes up and down by a few percentage points in a day, there can be sizable dollar amounts at stake.

But part of what you're trying to do here is avoid making panicked decisions. Big red or green arrows or commentators with raised voices generally don't induce calm. Also, those talking heads know nothing about you and why you invested in the first place. So don't base your actions on their pontificating and pronouncements.

Why Did You Invest in the First Place?

Let's say you're in the first half of your career. You probably invested in stocks because over the very long haul, they deliver better returns than the other investment choices that are easily available to you at an online brokerage firm or through your workplace retirement plan.

When you buy stocks, you're purchasing tiny little pieces of the profits that our capitalist system generates. Nothing about the events of the last few days suggests that the system is under siege. Quite the contrary: The markets may be spooked in part by the fact that the economy is humming along so nicely that companies will have to pay more for workers. That can hurt the profits that help drive stock prices and also lead to inflation.

What Is Your Timing?

You invest because you want to retire in four decades or send your kids to college in two decades, or buy a home or a boat in one. Or maybe it's something else entirely. Whatever the goal, it probably comes with a rough time horizon: You want to do this thing starting around that time.

The small overall decline in the **stock market** over the past few days pales in comparison with the large gains over the past few years. So hopefully you're still on schedule to meet your goals, absent any big health or job changes.

This moment of checking your gut, however, is as good a time as any to consider whether you have the right proportion of your money in stocks versus other options like cash, bonds or real estate that don't experience this kind of **volatility** or may not rise or fall in tandem with stocks. In other words, are you taking too much risk? Or too little? If so, buy or sell some stocks accordingly — not because of what the **stock market** will or will not do next but because you are or are not on track to pay for the things you want to buy someday.

Can You Predict What the Market Will Do Next?

Let me answer that one for you: No. Perhaps you got lucky with some individual stocks as a teenager or used what you learned in finance class to buy just the right mutual fund at exactly the right time.

Congratulations! But you're almost certainly more lucky than you are smart. Professionals rarely do so well over 50 years that their decisions about when to get in and out of a stock lead to better performance than they might have achieved by just putting money into an index fund that buys every stock in a particular category. And you can't know ahead of time whether you are that rare breed of market genius.

Still tempted to sell and wait out this latest market hiccup? Plenty of studies warn against this, including one that shows that missing out on just 10 of the best days in the **stock market** over 160,000 daily returns in 15 markets around the world can cause you to end up with about half of what you would have earned if you had stuck with an index fund over time.

How Much Does This Affect Your Net Worth?

Any decline hurts, even if it's only on paper and you don't plan on selling for decades. But consider everything else that might happen over that many years.

You will (hopefully) pay down your student loan debt. You will (hopefully) get promotions and raises or start a company that will increase your income. You will buy a home, and its value will probably go up over time, or at least match inflation. Or you'll rent and draw dividends from the freedom and flexibility that brings you.

In other words, you are not the **stock market**. There is so much more to your net worth (and, hopefully, self worth) than a bouncing **S**.**&P**. **500** chart. Check in with your life, and if it's better than it was a year or five years ago, think about that if the **stock market** keeps falling.

Can You Sleep at Night?

Some of us (O.K., me, although I do a good job of hiding it in my columns) are more anxiety-prone than others. And maybe there is only so far we can go toward suppressing those feelings.

So be it. Maybe holding stocks, or a high allocation of stocks in a college savings account for a 12-year-old (me again), isn't right for you. That's not a character flaw. But it does have ramifications. You may have to work more or work longer or take on a side hustle to meet your goals. If that doesn't bother you, lower your stock holdings accordingly.

Above all, know yourself. The call to action at times like this may feel urgent. But chances are that if you're new at this, you have many decades of investing ahead of you. So there's no rush to make a buy or sell decision right this very second.

* As Stocks Gyrate, It's Time to Measure Your Risk Tolerance

* You're No Coward if You're Keeping Some Money Out of Stocks

* 9 Points to Guide Your Investments in 2018

Document NYTFEED020180206ee26006v9

The New York Times

Contributing Op-Ed Writer
Opinion

The Stock Market Is Volatile Again. Get Used to It.

By Ruchir Sharma
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6 February 2018
05:45 AM
NYTimes.com Feed
NYTFEED
English

The fear generated by Wall Street's sharp fall in recent days had been greatly magnified by the calm that preceded it. Before the 8 percent decline in United States stocks over the past week — which was followed by a bounce back of nearly 2 percent on Tuesday — the **S**. **& P**. **500** had gone two years without suffering a drop that large. Spoiled by this unnaturally placid stretch, many Americans had forgotten what a routine market setback even looks like.

They better get used to this. In a typical year, according to data going back three decades, the market experiences a correction of about 10 percent. . What Americans are witnessing now is thus a return to normal market behavior, which has never followed a straight line.

This year could be pivotal, because the conditions that underpinned the steady upward march of stock prices are now likely to deteriorate. In the United States and around the world, stocks have been buoyed by the trifecta of accelerating global growth, low inflation and loose central bank policies, all of which are now poised to turn against the bubbly market.

Optimists believe that the global economy this year can still grow 4 percent, the pace it maintained during the post-World War II miracle. But the miracle was driven mainly by the postwar baby boom, which ended years ago. Many investors have yet to internalize the fact that 4 percent growth is unrealistic. Fewer workers means slower economic growth and will make it difficult for the world economy to sustain even its 2017 pace of just over 3 percent growth.

Fewer workers also means labor shortages and higher inflation. Unemployment rates are close to a 40-year low in developed economies, including the United States. If the United States economy keeps adding 200,000 jobs per month, as it did in January, the unemployment rate could fall below 3.5 percent by the end of the year. And a rate that low has never been sustained in the past.

This looming shortage of workers is now putting upward pressure on wage growth, which has been steadily rising in recent months. And historically, wage growth has been a strong driver of inflation, as workers use their expanded paycheck to bid up prices for goods and services.

This then is the big picture: Over the past year, investors worldwide have been pleasantly surprised by an unusual combination of economic growth beating their expectations and inflation undershooting expectations. These pleasant surprises fed an unnatural calm. Over the coming year, these forces are likely to reverse, as labor shortages slow growth and begin to drive up inflation and bring a normal level of **volatility** back to the markets.

The scale and timing of a turn in the markets is likely to be decided by the third leg of the trifecta: easy money. Central banks have been printing money like never before, holding interest rates at record lows for extended stretches. Investors have used this cheap liquidity to drive up prices for everything from stocks and bonds to Bitcoin and fine art. The United States **stock market** is now around 25 percent higher than it would have been had it grown at its historic average pace.

Stock values have rarely risen so high, yet many seasoned investors had come to believe that these nosebleed valuations could be justified as long as the Federal Reserve Board kept interest rates low. When investors are worried about the future, they move money into cash, and today their cash balances are at record lows. In other words, complacency was arguably at a record high when the correction began last week.

Watching their market wealth soar, even average middle-class Americans got caught up in the faith that nothing could go wrong. They started spending aggressively again, after dialing back in the wake of the 2008 financial crisis. The United States savings rate has fallen to a mere 2.4 percent, from post-crisis peaks of well over 6 percent. Consumer credit card debt is rising. By some estimates, the confidence inspired by rising stock prices accounted for a third of the economic growth over the past two years.

In the past, whenever the **stock market** has been this expensive, an increase in interest rates has brought it back down to earth. In recent years, the swelling size of the **stock market** has magnified the potential economic impact of a correction. If the **stock market** suddenly reverts to its long-term trend, implying a fall of almost 25 percent, it could push the American economy close to recession.

All eyes are now on the central bank. Confidence that the idyllic economic conditions of the past year will last indefinitely has been rattled, particularly as wage growth begins to signal a return of inflation. Many investors are fretting that the Fed may be compelled to raise rates faster than anyone had expected, just the kind of negative surprise that could deflate sky-high prices in all assets, and not only for stocks. The year 2018 may be remembered as the time when the moody market beast returned to its natural state.

Ruchir Sharma, author of “The Rise and Fall of Nations: Forces of Change in the Post-Crisis World,” is the chief global strategist at Morgan Stanley Investment Management and a contributing opinion writer.

A pedestrian in front of a **stock market** indicator board in Tokyo this week. | Franck Robichon/European Pressphoto Agency

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The New York Times

Op-Ed Contributor
Opinion
The Market Collapse Blame Game

By Desmond Lachman
841 words
6 February 2018
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NYTFEED
English

According to an old proverb, success has many fathers, but failure is an orphan. That proved to be all too true of the 2008-09 Great Recession: In the aftermath, nobody in the policymaking, financial or academic communities stepped forward to accept responsibility for the worst global economic setback in the past 70 years.

It's unlikely anyone will take credit for the current global market free fall, which, after three days, is clearly not just a correction but an overdue unwinding of years of excess. Whether the damage remains limited to markets or spills over into the general economy remains to be seen, but we could well be on the verge of another global financial crisis.

This despite the fact that the outgoing Federal Reserve chairwoman, Janet Yellen, repeatedly reassured us that we would not see another global economic crisis in her lifetime, while the academic economic community again distinguished itself by its virtual silence as bubbles formed in the market over the past few years. And just last month in Davos, Switzerland, President Trump boasted again that his administration's policies were leading to the **stock market** shattering records on a routine basis, while the bankers kept making risky loans as the music played on.

It's no surprise that sooner or later, the global **financial markets** would unwind as violently as they now seem to be doing, considering how far they were allowed to get out of line with their underlying values. It was only a matter of time before a market bust was going to occur.

It was not simply that nothing was done to stop global **stock market** valuations from reaching levels seen only three times in the past hundred years. It was also that government bond yields were allowed to drop to historically low levels, and nothing was done to stop financial institutions from making very risky loans at unusually low interest rates.

One can perhaps partly excuse the world's major central banks, including the Federal Reserve under Ms. Yellin's predecessor, Ben Bernanke, for having set in motion our present boom-bust cycle by their policy response to the Great Recession. Major economies relied too heavily on monetary policy to get past it, while refusing to deploy adequate and well-targeted budget stimulus measures.

With the economy then in danger of succumbing to a deflationary spiral and with interest rates having gone as low as possible, the world's central banks had little option but to buy government bonds on an enormous scale to encourage investors to take on additional risk. At the time, that seemed a price worth paying, even though it came at the risk of distorting **financial market** prices and creating a global market bubble.

Less easy to excuse was the Fed's failure last year to remove the low-interest-rate punch bowl when the global economic party was showing clear signs of getting out of hand. With the American economy having reached close to full employment, and with a 25 percent jump in equity prices and 10 percent depreciation in the dollar over the past year, why was the Fed so reluctant to increase rates? A more aggressive monetary policy in 2017 might have brought sense back to the market and reduced the chance that the American economy might overheat and bring inflation in its wake.

It is also difficult to excuse the Trump administration and the Republican-led Congress for providing us with an unfunded tax cut at precisely the wrong time in the economic cycle. With unemployment very low and the economy growing at a healthy clip, the last thing the economy needed was a fiscal stimulus that might stoke fears of inflation and bring the bond vigilantes out of the woodwork.

The academics and bankers also deserve blame for having learned so little from the world's last boom-bust cycle. Is it too much to ask of academic economists to learn that excessive asset price inflation is not consistent with long-run economic stability — and that their role should be to sound the alarm when bubbles are forming? Is it too much to ask of the financial sector to remember that making reckless loans gets us all into deep trouble when the music eventually stops?

I raise all these questions not as an exercise in finger-pointing but in the hope that over the weeks ahead policymakers, economists and politicians draw the right lessons about how we got into this very difficult economic and **financial market** situation. Only then will there be some chance that we might escape these boom-bust cycles, which now appear to be occurring on a regular basis.

Desmond Lachman is a resident fellow at the American Enterprise Institute. He was formerly a deputy director in the International Monetary Fund's policy development and review department and the chief emerging market economic strategist at Salomon Smith Barney.

The floor of the New York Stock Exchange on Tuesday. | Spencer Platt/Getty Images

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THE WALL STREET JOURNAL.
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Selloff Upends Low-Volatility Bets --- Large swings force investors to rethink the duration of quiet markets

By Gunjan Banerji and Alexander Osipovich
755 words
6 February 2018
The Wall Street Journal
J
B1
English

Volatility roared back into the stock market Monday, rattling traders and wrong-footing scores of investors caught wagering that share-price swings would remain muted.

The Cboe Volatility Index, or VIX, posted its largest-ever one-day increase, more than doubling by Monday's close to 37. That is the highest close since August 2015, when U.S. markets briefly went into free fall following a surprise devaluation of the Chinese yuan.

The VIX, the most widely cited market gauge of price swings, uses options activity to give investors a view of expected stock-price moves in coming sessions. It was an obscure measure even on Wall Street until ructions in the VIX during the early stages of the 2008 financial crisis foretold larger problems ahead.

Since the crisis, the VIX has generally been depressed, and its levels hit new lows last year as the Dow Jones Industrial Average and other major indexes soared to new highs. The decline in the VIX spurred increased interest among investors in making bets that volatility would fall further, a wager widely known in trading circles as "shorting the VIX" and the "volatility carry trade."

Those seeking to short volatility can either buy financial products such as some exchange-traded products that seek to benefit from a decline in price swings, or they can borrow products that track the VIX and sell them short, seeking to repurchase them later at a lower price and pocket the difference. When stocks plunge and volatility surges, though, investors who have been short volatility face significant losses.

"With volatility being so low, people took on positions that were effectively leveraged," said Jason Draho, head of tactical asset allocation for the Americas at UBS Wealth Management.

Exchange-traded funds that profit in calm markets minted money in 2017, as volatility fell further and further during a long period of regular stock-price increases, before turning sharply lower more recently. Two of these products recorded losses during January after several months of gains, though investors continued to pile into the trade.

The ProShares Short VIX Short-Term Futures ETF, with the ticker SVXY and which was launched in 2011, lured a record amount of funds in January and brought in more than $500 million on Friday, the most ever in a single day, FactSet data show. It plunged 32% on Monday.

Money has also flown into the VelocityShares Daily Inverse VIX Short-Term exchange-traded note, launched in 2010. It dropped 14% during Monday's session and dropped roughly 84% after the market closed.

Potentially adding to the large market swings on Monday was options positioning. Rather than paying for options to protect portfolios, some investors have turned to selling options for incremental income, analysts said -- another strategy that exposes the seller to outsize losses in the event of a large market move.

"Equity volatility popped more than people thought because of this new leverage in the system," said Peter Cecchini, global chief market strategist at Cantor Fitzgerald, referring to such options selling for income.

Investors who sold bearish put options may have been forced to sell shares as stocks slipped, with certain option positioning on the S&P 500 concentrated around the 2700 level, Mr. Cecchini said.

The S&P dropped 113.19 points Monday to 2648.94, after earlier trading as low as 2638. As the equity index continued to fall, this positioning increased selling.

"That forces people to sell shares and exacerbates the market selloff," Mr. Cecchini said. "That is precisely what happened today."

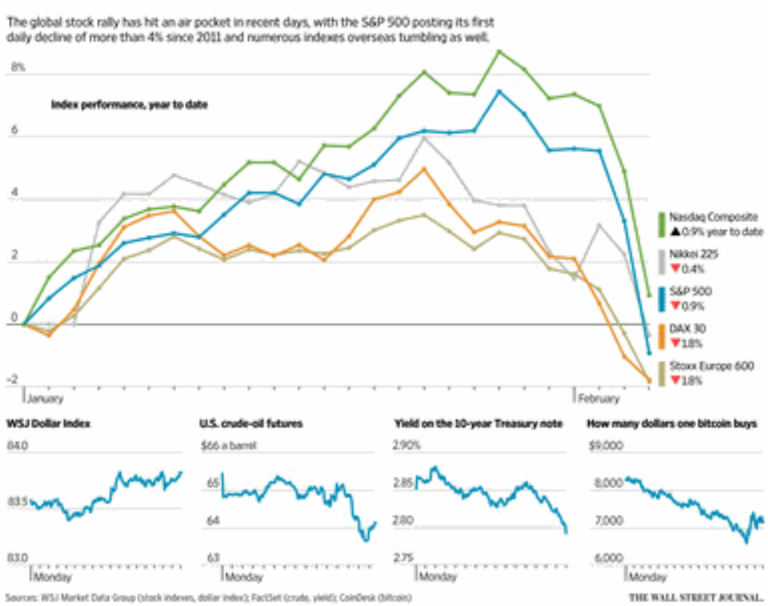
Some analysts pinned the wild move on automated trading strategies that kicked in when the algorithms saw the market falling rapidly. Adding evidence to that theory: The market's selloff appeared to accelerate once the **S&P 500** fell below 2700, a threshold where investors might have placed orders to automatically sell **stock-market** futures to cover their losses.

Such selling could have in turn pushed the market down further.

Similarly, the **S&P 500** broke through its 50-day moving average, a key technical indicator that could have triggered automatic sell orders, around 2:25 p.m. EST.

"I think it's more technical than panic," said Binky Chadha, chief strategist at Deutsche Bank. "It's a snowball. It rolls down a hill and gets bigger and bigger."

Amrith Ramkumar and Akane Otani contributed to this article.



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The Intelligent Investor: Stock Market Didn't Get Tested, but You Did

By Jason Zweig
646 words
6 February 2018
The Wall Street Journal
J
B1
English

Stop trying to make sense of the **stock market**.

The one question every investor was asking on Monday has no answer: Why? Why did the **Dow Jones Industrial Average** close down nearly 1,200 points, or 4.6%?

Market commentators are already arguing that stocks were bound to fall because interest rates are rising and inflation is sure to jump as the economy heats up. But a week or two ago, before stocks stumbled, analysts were saying just as glibly that moderate increases in interest rates and inflation were good for stocks.

Yes, stocks have been expensive by historical measures for some time now. And investors have been extraordinarily optimistic. In January, near-term earnings estimates for the companies in the **S&P 500** rose by the largest percentage since 2002, according to FactSet.

What's more, the abnormal smoothness of the **stock market** over the past couple of years set investors up for a shock whenever stocks did fall at least 5%, as they did on Monday.

As I pointed out last month, in the low-**volatility** market we have seen until recently, "even slight declines are apt to set off talk of Armageddon, and you will need to focus harder than ever on long-term returns to keep short-term losses from rattling you."

That's because the pain of a market drop depends not merely on its size, but on its steepness relative to recent experience. A 5% drop back in late 2008 or early 2009 was almost routine; now it feels like a frightening deviation.

Bear in mind, too, that some index funds -- those autopilot portfolios that seek to match the market by holding all the stocks in a benchmark -- tend to execute their trading orders around the close of trading at 4 p.m. Eastern time. That can reduce a key source of buying during the middle of the trading day.

But just as no one knows, to this day, why the **stock market** crashed in September 1929 or October 1987, searches for a rational explanation of Monday's madness are futile.

The novelist Joseph Conrad understood human nature. In his memoir, "A Personal Record," published in 1912, he recounted a chilling story from his family's history in Poland.

After a troop of Cossacks invaded the grounds of the home of Conrad's wealthy grand uncle, dozens of peasants surged in and around the house. A loyal servant and a local priest placated the crowd, and the tension began to dissipate.

Then, as much of the crowd started to head home, one of the peasants stepped to the window. He bumped into a dainty table; as it hit the floor, coins clinked inside it. He bashed it open, and gold coins spilled out.

Instantly, the crowd shifted from retreat to rampage. They swarmed inside and "smashed everything in the house, ripping with knives, splitting with hatchets, so that, as the servant said, there were no two pieces of wood holding together left in the whole house."

That's what markets are like. Tens of millions of people don't always act rationally in response to new information; often, they react to nothing but how they think other people are acting or will act.

Monday's madness is a reminder that investing in stocks doesn't automatically make people rich. Twice in the past 20 years -- between 2000 and 2002, and again between 2007 and 2009 -- the **stock market** has cut investors' wealth roughly in half.

No one can say when that will happen again, but everyone should know that it can -- and very well might. If a 6% daily drop makes you squirm, then you probably have too much invested in stocks for your own psychological good.

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The New York Times

Business Day
4 Takeaways From Monday’s Stock Market Sell-Off

By The New York Times
749 words
5 February 2018
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English

Stocks around the globe tumbled on Monday, extending a sell-off that began last week. Investors, who had been riding a wave of optimism last year, have recently shown nervousness as global economic conditions have been shifting.

The S.&P. 500 had its biggest one-day drop in more than six years

■ The Standard & Poor’s 500-stockindex fell more than 4 percent, erasing its gains for the year. The 4.1 percent drop was the worst for the S.&P. since August 2011.

■ The Dow Jonesindustrial average fell more than 1,000 points, its biggest point drop ever. But that record is a function of the Dow’s size, which is the largest it has ever been. In percentage terms, it fell 4.6 percent, something it also did in 2011.

■ Bond yields have risen fast in recent weeks as people have moved money out of stocks into these traditional safe havens. Yields were down Monday from a 4-year high on Friday.

In a strange way, investors are nervous that the global economy is doing too well

The rise in stock prices over the last decade was fueled, in part, by some of the lowest global interest rates since World War II. Central banks around the world lowered rates and pushed down yields on safe government bonds, part of an effort to help economies limp their way out of the Great Recession.

The goal was to encourage investors to put their cash to work in the economy — for example, by buying corporate stocks and bonds. The theory is that the fresh flood of money would make it easier for companies to raise capital, invest in their businesses and hire workers.

That strategy, in many ways, paid off. For the first time since the financial crisis of 2008, the world’s largest economies are growing in unison.

But what’s good for the economy isn’t always good for the markets.

Central banks, led by the United States Federal Reserve, have started to remove some of the supports that helped supercharge stock prices over the last decade.

The Fed started raising rates two years ago. With rates going up, money is not as cheap. The robust jobs report last week fueled hopes that wage growth would follow. But higher wages could lead to higher inflation, creating new challenges for the Fed to manage, perhaps prompting it to raise rates more quickly.

Despite the drops, there have been far blacker Mondays

Measured by points, Monday’s drop was the largest on record for the Dow and the S.&P. 500.

The previous biggest point declines for the two indexes occurred on Sept. 29, 2008, at the height of the financial crisis.

Weeks after Lehman Brothers failed in September 2008, lawmakers in the House of Representatives rejected a $700 billion economic rescue plan. The move sent markets tumbling.

But over the past three-plus decades, investors have endured a number of bigger percentage drops in the **stock market**.

The S.&P. fell 8.81 percent that day in 2008. That was more than twice as much as Monday's fall.

Keep one important idea in mind: Take the long view

The way we sometimes think — and the news media talks — about markets can make sell-offs like Monday's seem more dramatic than they are.

Our perceptions are distorted, in part, by thinking about swings in terms of points rather than in terms of percentages. The problem with that thinking is that our idea of big point moves was most likely shaped when the Dow was much smaller — and a drop in several hundred points would have made up a greater share of the average than it does today.

This recent decline so far has returned the market roughly to its level in mid-December, less than two months ago. That doesn't mean markets won't keep dropping, as they are wont to do. But it may not be time to sell.

Stephen Grocer, Neil Irwin and Matt Phillips contributed reporting.

* Dow Jones and S.&P. Slide Again, Dropping by More Than 4%

* Live by the Dow, Die by the Dow? Trump Is Quiet on Market

* Investors Fear the Tax Cuts Will Work Too Well

The floor of the New York Stock Exchange on Monday, when stock indexes set records for point losses but not for percentage losses. | Brendan McDermid/Reuters

Document NYTFEED020180206ee26000p1

THE WALL STREET JOURNAL.
U.S. EDITION

Corporate-Bond Market Remains Calm --- Narrow premium over Treasurys signals lack of worry about companies' health

By Mike Bird and Riva Gold
923 words
6 February 2018
The Wall Street Journal
J
B12
English

Stock indexes around the world continued to plunge Monday, but investors point to one reassuring factor in global markets: People aren't getting nervous about corporate credit.

The difference between yields on corporate bonds and less risky government debt continues to narrow, suggesting that share-price declines aren't because of widespread fears about the financial health of the world's companies.

Previous U.S. **equity-market** corrections since the 2008 credit crisis have been matched by big moves in corporate-credit spreads, asinvestors sought a higher premium over government bonds to compensate for their increased concerns over corporate health.

Spreads on dollar- and euro-denominated corporate credit ticked down to their lowest levels since 2007 Friday, indicating that bond buyers don't currently require a greater payoff against the risk that such debt defaults.

For example, while Apple Inc.'s stock is now down about 7.5% in the year to date, spreads on the company's 2027 bonds have dropped to 0.59 percentage point Monday from 0.65 percentage point at the beginning of the year.

U.S. corporate bonds offered yields just 1.1 percentage points more than government bonds of the same maturity, according to IHS Markit's iBoxx indexes, barely higher than Friday's 1.08 points, the lowest level seen since 2007.

The spread on European corporate bonds was even lower on Friday, at just 0.82 percentage point.

On Monday, European, Asian and U.S. stocks fell again. The Stoxx Europe 600 sank 1.6%, the largest drop in a year and a half, Japan's Nikkei Stock Average fell 2.5% and the **S&P 500** slid 4.1%. The spread on European corporate bonds barely budged, ending at 0.83 percentage point.

"I think the resilience of credit to the most recent selloff within equity should provide equity investors with a little bit of comfort," said David Riley, head of credit strategy at BlueBay Asset Management.

"It suggests credit investors still feel very comfortable with corporate-credit fundamentals, the earnings outlook and the ability of the corporate sector to absorb higher rates," he added.

During previous market turns like the nearly 14% drop of the **S&P 500** in February 2016 from its May 2015 high, the spread on the iBoxx U.S. corporate index rose by nearly 0.9 of a percentage point.

Similarly, during the height of the European sovereign-debt crisis in 2011, when the **S&P 500** dropped 18%, corporate spreads rose 1.7 percentage points.

To be sure, those share-price declines were far larger than the drawdown in global equities over the past week.

But so far, there is little indication that the selloffs are based on expectations of significantly deteriorating economic conditions and company profits are mostly beating expectations. With roughly half of **S&P 500** companies having reported their fourth-quarter earnings, 78% have beat analysts' expectations, compared with 64% in a typical quarter, according to Thomson Reuters data.

"Really, there is no recessionary risk out there that's telling you not to invest in bonds paid for by the cash flow of companies," said Ewan McAlpine, senior client portfolio manager at Royal London Asset Management.

Data on Monday continued to point to an acceleration in global growth that should be supportive for both stocks and credit. The IHS Markit eurozone January purchasing-managers index reached its highest level since June 2006, while the U.S. Institute for Supply Management's nonmanufacturing PMI rose to 59.9, well above the 56.5 expected.

The credit market "is a supportive factor in my view that I don't think we've hit the turn in the equity markets," said Dave Lafferty, chief market strategist at Natixis Investment Managers.

So why are stocks falling?

The difference between the two asset classes this week may in part reflect stocks' more exuberant start to the year. Equity markets drew record inflows and the **S&P 500** rose 5.6% in January, its biggest monthly gain since March 2016. Since the beginning of the year, credit spreads on both the euro and dollar iBoxx corporate indexes have declined by roughly 0.1 percentage point.

"All of the discussion at the moment that is negative about the **equity market**, none of it is about the economics, it's all about those valuations and ratios," Mr. McAlpine said.

Investors have been debating whether U.S. stocks look expensive, and what valuation should be used to measure that. The **S&P 500**'s 12-month rolling price/earnings ratio, a popular valuation measure, reached 23.4 in January, its highest level since 2002.

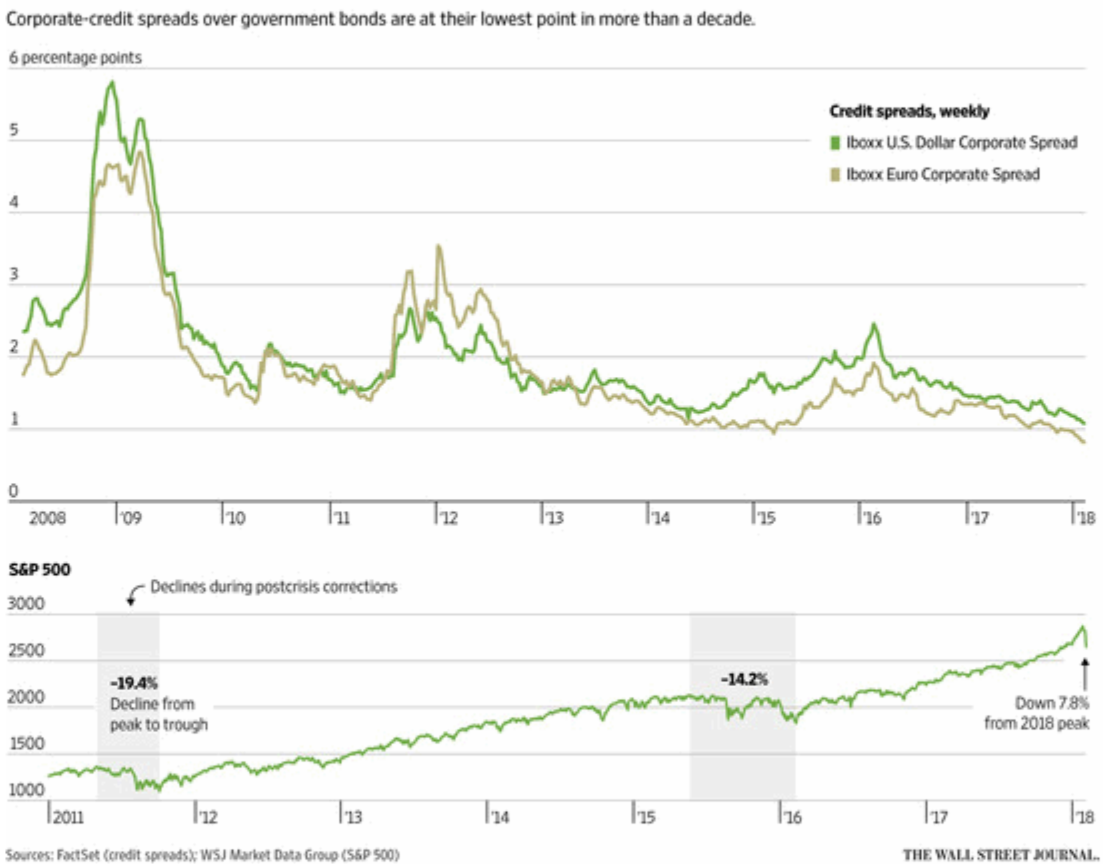
But not everyone believes that the message from corporate-debt markets is the correct one.

On Monday, S&P Global Ratings warned that the global proportion of highly leveraged companies, with a debt-to-earnings ratio above 5 to 1, has risen by 5 percentage points since 2007, to 37%.

Higher debt levels leave companies vulnerable to unexpected fast increases in interest rates, which would make it more costly to pay off their debt.

"When you are seeing this type of **volatility**, it does raise the question of whether credit spreads should be trading near all-time tights," said Sunil Krishnan, head of multiassets funds at Aviva Investors.

"I don't think you're getting very good compensation for **volatility**."



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THE WALL STREET JOURNAL.
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U.S. News: Service Sector Hits 10-Year High --- Activity ramps up, boosting economy amid new signals of business confidence

By Sarah Chaney
404 words
6 February 2018
The Wall Street Journal
J
A2
English

A measure of service-sector activity across the U.S. picked up in January to reach a 10-year high, suggesting strong momentum in the sector powering the bulk of the U.S. economy.

The Institute for Supply Management on Monday said its index of nonmanufacturing activity -- tracking industries including health care, finance, agriculture and construction -- rose to 59.9 in January from 56 in December, the best index reading for records dating back to 2008.

This figure exceeded expectations of economists surveyed by The Wall Street Journal, who had forecast a January reading of 56.5. A number above 50 indicates expansion.

The rise was driven by increases across a broad swath of components, including new orders and employment indexes. The new orders index rose to 62.7 in January from 54.5 in December. The employment index increased in January to 61.6, the highest level on record.

Anthony Nieves, chair of the ISM committee that oversees the survey, said he sees the strength in services continuing. "The economy has come out really strong for the month of January," Mr. Nieves said. "Our respondents are telling us it's due to the confidence level they have within their companies."

The rise in the new orders metric was propelled by a range of factors, including business confidence that the tax overhaul will boost investment, Mr. Nieves said.

January's acceleration comes after two consecutive months of pullback in the services sector.

"The ISM indices have been especially **volatile** in recent months, but January's release is a reassuring sign that the economy has continued to gather momentum at the beginning of 2018," said Michael Pearce, economist at Capital Economics, in a note to clients. "We expect GDP growth of 2.5% for 2018 as a whole, faster than the 2.3% growth seen in 2017."

Other data have recently pointed to broadening economic strength. Gross domestic product, a broad measure of goods and services produced across the U.S., rose at an annual rate of 2.6% from October through December, the Commerce Department said. The measure was bolstered by strong business and consumer spending.

A separate ISM gauge that tracks activity in the much-smaller manufacturing sector maintained momentum in January.

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THE WALL STREET JOURNAL.
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Heard on the Street
Fed Walks Fine Line on Stimulus

By Justin Lahart
554 words
6 February 2018
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[Financial Analysis and Commentary]

Investors are suddenly worried about just how much the Fed might tighten policy, sending the **Dow Jones Industrial Average** down over 1800 points in just two days. They are right to be concerned.

Federal Reserve tightening cycles always tend to get messy. Throw in fiscal stimulus hitting the economy just as the Fed will be trying to cool it down and already-steep bond and **stock-market** valuations, and this cycle looks messier than most.

Last Friday's job report provided some of the strongest evidence yet that a tight labor market is finally throwing off faster wage growth. The Dow promptly had its largest point loss since 2008. That wage strength is a sign for the Fed that inflationary pressures are building, opening the possibility that the central bank may have to raise rates faster than it has forecast in order to prevent the economy from overheating.

This is a phase that has always been tricky for the Fed. It mustn't tighten so little that it falls behind the curve, but also not so much that it sends the economy into a recession. It is something the Fed has only accomplished occasionally, most notably in the so-called soft landing it helped guide the economy to in 1994.

The tax package that got signed into law late last year only complicates things. Lower corporate tax rates and the tax-cut-related bump many people are now seeing in their paychecks will boost the economy this year. The Fed faces a situation in which it will be tapping on the brakes as the fiscal policy is pushing on the accelerator. Making the situation even more complex, nobody knows exactly how much of a boost to growth the tax plan will induce or how long it will persist.

Then there is the matter of markets. Even after the recent selloff, the **10**-**year Treasury**'s yield of 2.79% remains historically low. As a result, it would take much less of an increase in yields to send **bond prices** down significantly than if at the 4% the notes yielded just before the last recession started.

Stocks are also expensive, in large part because low Treasury yields have made them seem relatively attractive to many investors. Even after the recent selloff, the **S&P 500** trades at 17.5 times expected earnings, according to FactSet, near the highest since 2004. That means that stocks, too, could be unusually sensitive to Fed tightening.

The situation might have been very different if today's fiscal stimulus had come in, say, 2012, points out Robert Barbera, co-director for the Center for Financial Economics at Johns Hopkins University. Back then there was plenty of slack in the economy, with the unemployment rate averaging 8.1%, so the Fed wouldn't have had to worry about overheating. It also might not have had to buy assets so aggressively -- actions that contributed to today's richly valued stock and bond markets.

Unfortunately, the Fed and investors aren't dealing with what might have been, but what is. The tax cuts and high valuations so many have been cheering could end up being the **bull market**'s undoing.

page,5043

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The New York Times
The Conversation
Opinion
On What Planet Is the F.B.I. Anti-Republican?

By Gail Collins and Bret Stephens
1,610 words
6 February 2018
05:45 AM
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Gail Collins: Bret, have you ever thought about how much politics can be like … the Super Bowl?

Bret Stephens: Hmm. Please say more.

Gail: Actually, I wanted to compare it to the fight over the House Intelligence Committee memo. We go through a buildup that takes forever. The nation waits on edge. Nobody can talk about anything else. Then it happens! And no matter who wins, for most of the country it's like — meh.

Of course, right now, if you're a Philadelphia Eagles fan, the Super Bowl was the biggest moment in history. And if you listened to Donald Trump talk about the Nunes memo on Monday, you'd think the same thing. But for everybody else, it's sort of a fizzled firecracker.

Bret: You're right. The Nunes memo, like the Super Bowl, is what Daniel Boorstin called a "pseudo-event," which is basically a made-up (or trumped-up) drama, the chief purpose of which is to give people something to talk about in a way that benefits the political or corporate interests of whoever invented the drama in the first place.

Gail: And to think I used to believe football was invented as a way to keep conversation going at family reunions.

Bret: Also, the memo, like football, has a way of leaving nearly everyone involved badly concussed. I think it is causing brain damage among some Republicans. Sebastian Gorka, who's like Steve Bannon without the good looks, said the other day that the memo disclosed abuses of power that were "100 times bigger" than British abuses in the American colonies.

Gail: Among the many weird aspects of our current situation is the way everybody's sort of switched sides on the F.B.I. Must admit that until rather recently, I was generally … wary of all things Federal Bureau-related. As investigators, I thought, they were way overrated. And of course I was aware that your average F.B.I. guy was on the conservative end of the political scale.

If we ever get back to normal, I suspect I'll revert to being wary. But right now we — and by we I mean people like me — are rooting for them. They're our protectors against Trump and the Russians.

Bret: Our colleague Frank Bruni wrote a wonderful column a few weeks back called "Democrats Are the New Republicans." Fiscal responsibility: Check. The Russian government is not to be trusted: Check. Moral character counts in politics: Check. Law enforcement demands our highest respect: Check.

For me as a conservative, the experience is just head-snapping.

Suddenly we're supposed to believe that Carter Page — a man who charitably can be described as Vladimir Putin's useful idiot — is a martyr to American civil liberties.

Suddenly we're supposed to think that people like Deputy Attorney General Rod Rosenstein, and the F.B.I. director, Christopher Wray — both of whom were appointed by Trump — are anti-Trump villains.

Suddenly we're supposed to think that an election that Trump won was stolen from him.

Gail: Frank is always ahead of the rest of us. And once again, you and I agree. So let's stop all this comity and find something to fight about. Tax cuts! That seems to be our one surefire point of dispute these days.

You've argued that the congressional elections won't be as bad for Republicans as people have been predicting because the public will be happy about the tax cuts. You may be right — although I'm hoping critics can convince average Americans their boon is a tiny speck compared to what the rich are raking in.

But doesn't it worry you that the debt is soaring so high, the **stock market** is suddenly looking shaky and the Fed is worrying about inflation? It feels like the beginning of something bad. Although I immediately admit that when the Democrats were working on expanding the safety net, I pooh-poohed the whole deficit issue. The one perpetual rule of politics, I think, is that the people on neither side care about the deficit when they're trying to get what they want.

Bret: The biggest mistake deficit hawks make is to suppose that creditors own their debtors — now in vogue among those who think that we are at Beijing's mercy because they own so much U.S. government debt. But the truth is usually just the opposite: debtors own the creditors — provided, of course, that the debts are sufficiently large. Just think of Donald Trump's business career.

That's probably a bit glib, but I really do think the deficit is not much of a problem so long as investors, foreign and domestic, continue to have faith in the economy. Among the ingredients in that faith are the prospects for economic growth, the ease of doing business, the predictability of legal and regulatory frameworks, the attractiveness of the culture, society and environment, and so on. Most of the old debates between Republicans and Democrats center on just which parts of that overall package should matter most.

Gail: Well, the global warming one isn't exactly teeny. But I see your point. Go on.

Bret: The markets do worry me. People a whole lot smarter than I am on this subject, like Elliott Management's Paul Singer, have been saying for some time that the markets are overheated. And we've been living in an era of near-zero interest rates for so long that rising interest rates might be traumatic for many companies and investors.

But you were asking me about the tax cuts. And I want to tell you, that $1.50 extra in my paycheck is really putting a bounce in my step!

Gail: You can buy me a coffee! Well, not at Starbucks, but maybe the guy with the cart on the corner. Tell me your post-groundhog predictions. Will we still be shivering in March? I'm kinda confident Congress will find some way to keep the country more or less in operation — but what about the Dreamers? Is there an immigration deal the president can't screw up?

Bret: Uh-oh. The trouble with making short-term predictions is that people might just remember what I have to say. (However, like John Maynard Keynes, I guarantee you that in 100 years we'll all be dead.)

But, anyway, here goes: I don't think there's going to be a deal. I think we're going to live from one continuing resolution to the next. Both parties see immigration as a political winner for them in the fall, and so they are not going to want to bury it in the form of a compromise that leaves a lot of people in their respective bases unhappy.

Gail: The groundhog sees Congress's shadow and gets depressed …

Bret: Punxsutawney Phil might want to cover his ears for this one: Barring a market meltdown, Democratic chances of retaking one or both houses of Congress are slipping. Trump outplayed Chuck Schumer over the government shutdown, and he's outplaying (or out-demagoguing) Democrats on immigration, too. For immigration restrictionists, showing charity toward the Dreamers is a relatively small price to pay for building a wall and fundamentally changing the rules of the game when it comes to who gets a shot at coming to this country. His State of the Union line that "Americans are dreamers, too" pretty much sums it up.

I could be wrong for all sorts of reasons, but I think Democrats need to stop playing to the most passionate quarters of their Trump-hating base and start targeting a different demographic: namely, the millions of people who voted for Obama in 2012 but went for Trump in 2016.

Gail: It's the economy, stupid? Not you, Bret, of course.

Bret: I think it's a combination of the economy and the culture. Donald Trump is the embodiment of a raised middle finger at a certain kind of cultural self-satisfaction and smugness coming from the "elites," or "coasts," or whatever else you might want to call, well, us.

The whole point of a middle finger is to be rude and rageful, so Trump's crassness is exactly what his supporters crave. He's been adept at doing something tabloid journalism has done forever, which is to combine salaciousness with moral outrage in the same package. It's the political equivalent of salted caramel or sweet-and-sour sauce. And if he can pull that off while the economy is growing against widespread predictions of doom, he's on the road to winning.

Gail: Not giving up on the doom, but go on …

Bret: Trump's opponents — not just Democrats but also conservative Never — need to figure out a way of countering this. Whatever the answer is, it can't be the flustered outrage that's been our trademark for the past couple of years. Trump's opposition needs less self-important indignation, more charitable judgments of Trump's base, and a pragmatic message aimed at middle class anxieties.

Basically, it needs a figure such as Gov. John Kasich of Ohio, or Gov. John Hickenlooper of Colorado, or — subtracting libido, finger-wagging, and other character defects — Bill Clinton.

Gail: Whee. Let's end on that note. I know when I'm ahead.

Supporters along the route of President Trump's motorcade from Trump International Golf Club to Mar-a-Lago in West Palm Beach, Fla. | Al Drago for The New York Times

Document NYTFEED020180206ee260035z

The New York Times

National Desk; SECTA
Why the Plunge Isn't as Scary as It Seems

By NEIL IRWIN
885 words
6 February 2018
The New York Times
NYTF
Late Edition - Final
14
English

If measured by news headlines, you might assume these are dire times in the **financial markets**.

There is a "market meltdown" in the United States and "ugly, ugly scenes" in the European exchanges. Evidence of higher wages was "whacking" global markets last week, while higher bond yields threatened to "topple" a multiyear rally. On Friday, the **Dow Jonesindustrial average** fell by 666 points, as if scripted by a devilish hack, which was followed by an even steeper decline Monday, amid erratic trading.

There is an important idea to keep in mind at a time like this: Take the long view.

This market decline so far has returned the market roughly to its level in mid-December, less than two months ago. The 7.8 percent drop in the Standard & Poor's 500 over the last six trading days is similar in scale and speed to drops in January 2016 and August 2015, neither of which left lasting scars, and is short of the 10 percent drop that would qualify as a market correction.

But some common cognitive errors are making this sell-off seem more dramatic than it is. And the reasons behind it may be more benign than it seems at first glance.

Media coverage frequently emphasizes moves in the **Dow Jonesindustrial average**. But you probably developed your intuition for how to interpret those numbers at a time when the index was much lower.

The Dow fell by 1,175 points Monday, which represents a quite large 4.6 percent decline. But while it was the biggest single-day point decline, there were steeper percentage declines on several occasions during the global financial crisis and its aftermath, not to mention the 508- point drop in the Dow in 1987 that represented a 22.6 percent market crash.

At a minimum, update your mental calculus of what constitutes a "big" market swing. Even better, focus on percent changes rather than point swings in an arbitrarily constructed index.

But our perceptions are distorted by more than thinking of points rather than percentages. The last 18 months have been one of the least **volatile** periods for the **stock market** in modern times. Humans have a bias toward recency, an inclination to let recent experience shape our expectations for the future.

The **S**.**&P**. **500** did not decline by more than 2 percent on a single trading day in all of 2017, which helps explain why Friday's 2.1 percent drop seemed so startling. (The percentage drop on Monday was a much rarer event, one that last occurred in 2011.)

But 2017 was weird. There were five such days in 2016, six in 2015 and four in 2014. In 2011, there were 21 trading days in which the S.&P. fell by more than 2 percent, nearly two per month. A bit of overreaction is as natural as people in normally dry Los Angeles having trouble driving in the rain.

There's no doubt that the 7.8 percent drop since Jan. 26 is substantial; it represents nearly $2 trillion of paper wealth. But you find some better news underneath that unpleasant fact when you look at what has happened in the bond market while stocks have been falling.

Frequently when investors become more pessimistic about the economy, stocks fall and the yield on bonds falls as well. That pattern happens because a weaker economy implies not just lower corporate profits (hence the falling stock indexes) but lower inflation and continued low interest rates from the Federal Reserve (which implies bonds are more valuable and their yield should fall).

But that hasn't been the pattern in this downturn. During the **stock market** swoon on Friday, the yield on **10**-**year** **Treasury** bonds rose sharply. Bond market measures of future inflation rose. Even after that trend reversed during the Monday sell-off, interest rates are still higher after this drop in markets (2.7 percent at Monday's close) than they were before (2.66 percent on Jan. 26).

Instead of reflecting economic pessimism, this **stock market** sell-off seems rooted in a form of optimism -- that employers will have to pay higher wages, cutting into profits, and that higher inflation will cause the Fed to raise rates faster than had been assumed. Throw in some worry that markets were getting a little overheated and you have a recipe for the downturn we've just witnessed.

In other words, this bad news for stock investors seems to be driven in part by good news for workers. And since most people earn more money from their jobs than from their investment portfolios, that's a trade a lot of people would be happy to take.

This downward swing in markets may be the kind of occasional stumble that every **bull market** experiences, or could be the beginning of the end of a market rally that has been going on for an awful long time.

But regardless of which it becomes, it's good for everyone's mental health to look beyond the day's headlines and focus instead on percentage changes instead of point changes -- and on historical patterns and the "why" behind the day's drop in the markets.

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The New York Times

NEWS ANALYSIS
National Desk; SECTA
A Run With the Bulls Has Its Perils

By PETER BAKER and BINYAMIN APPELBAUM
1,440 words
6 February 2018
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English

WASHINGTON -- As President Trump boasted about the economy during a speech on Monday, he left out one of his favorite lines. Nowhere did he mention the skyrocketing **stock market**.

Viewers at home understood why. In the corner of their television screens, a graphic showed the **Dow Jonesindustrial average** seemingly in free fall -- down 500 points, down 600, down 800, down 1,000.

By the time a **bullish** Mr. Trump was done speaking in Blue Ash, Ohio, the **bearish** market had plunged by nearly 1,600 points before recovering somewhat to close 1,175 points down.

No president in modern times has connected his political fortunes to the **stock market** as much as Mr. Trump, who relentlessly cited its meteoric rise as a sign of his success at restoring confidence in the American economy. But the drastic sell-off on Friday and Monday demonstrated why most presidents scrupulously avoid talking about short-term gyrations in share prices: If you live by the Dow, you may die by the Dow.

Barely a week went by last year when Mr. Trump did not crow about the rising market, making it a major talking point for his case to the country that he had made a difference. He took credit for the market at least 25 times in January alone. Even when the Dow fell 363 points on the day of his State of the Union address last week, Mr. Trump simply ignored the drop and talked about how the market had ''smashed one record after another'' since his election.

Despite the stumble of the past two trading sessions -- totaling 1,841 points, or 7 percent -- the Dow remains far higher under Mr. Trump, and there is no sign that the broader economy has lost momentum. But critics who have chafed at what they considered the president's shortsighted boasting for the past year saw Monday's meltdown as overdue comeuppance and eagerly piled on.

''Good time to recall that in the previous administration, we NEVER boasted about the **stock market** -- even though the Dow more than doubled on Obama's watch -- because we knew two things: 1) the **stock market** is not the economy; and 2) if you claim the rise, you own the fall,'' Jay Carney, a White House press secretary for President Barack Obama, wrote on Twitter.

It would be an exaggeration to say that Mr. Obama never trumpeted the market's performance -- ''the **stock market** is booming,'' he said in 2014, a few days after boasting, ''I don't have to tell you about the **stock market** and where that's gone.'' But it was rare enough that it stood out. Likewise, Presidents Bill Clinton and George W. Bush made a point of generally avoiding public commentary on short-term market movements.

After Monday's tumble, Mr. Trump's aides were left in the awkward position of ignoring it or explaining that it was not especially meaningful. Treasury Secretary Steven Mnuchin, who accompanied Mr. Trump to Ohio, declined to comment on the market when he encountered reporters on Air Force One during the trip back to Washington and again on the tarmac after it landed. The television on the plane was tuned to Fox Business Network as it dissected the day's dark developments.

''Look, markets do fluctuate in the short term. We all know that,'' Raj Shah, a White House spokesman, told reporters en route to Ohio when the market was heading down. ''And they do that for number of reasons. But the fundamentals of this economy are very strong and they're headed in the right direction -- for the middle class, in particular."

After the president returned to the White House, his press secretary, Sarah Huckabee Sanders, issued a written statement.

"The president's focus is on our long-term economic fundamentals, which remain exceptionally strong, with strengthening U.S. economic growth, historically low unemployment and increasing wages for American workers," she said. "The president's tax cuts and regulatory reforms will further enhance the U.S. economy and continue to increase prosperity for the American people."

Those tax cuts may actually be contributing to the market's decline. Analysts attributed plummeting share prices to Friday's job report, which showed wages beginning to rise as the economy nears full employment. Rising wages are a good thing for those who receive them, and for the presidents who seek to stimulate them, but investors see them as a sign of possible inflation and higher interest rates.

Mr. Trump pushed through a $1.5 trillion tax cut plan in December to fuel faster growth despite warnings from economists that the economy did not need the help. The economy is growing slowly by historical standards, but the low level of unemployment suggests that it is also growing about as fast as it can.

Instead of fueling growth, investors worry that the extra money Mr. Trump is pumping into the economy through tax cuts and, if he is successful, with a $1.5 trillion infrastructure plan will inflate wages and prices. And that could prompt the Federal Reserve to raise interest rates more quickly, suppressing growth to keep a lid on inflation.

"Even before the fiscal stimulus plan has really begun to kick in, we are already seeing markets worrying more about inflation," said Torsten Slok, the chief international economist at Deutsche Bank Securities. "They are coming to the conclusion that the U.S. economy is in danger of overheating."

Concern about rising deficits may be weighing on **financial markets**, as well. The federal government, which competes with private investors for available funds, plans to borrow almost $1 trillion this year, a big jump from last year's total of $519 billion, the Treasury said last week. That is a direct result of the decision to cut taxes without reducing federal spending. Indeed, the administration is now pushing for more spending on defense.

Mr. Trump also decided last year that he would not nominate Janet L. Yellen for a second term as Fed chairwoman. Instead, he nominated Jerome H. Powell, who was sworn into office on Monday as the market opened for business.

Mr. Powell, who had been a Fed governor since 2012, has emphasized continuity. But investors have a long history of anxiety about new Fed chairmen. During Alan Greenspan's first months in office in 1987, the **stock market** lost more than 30 percent of its value. And Mr. Powell is a relatively unknown quantity on Wall Street.

Still, some analysts cautioned against overinterpreting the meaning of market movements.

"In many cases, it is near impossible to figure out what moves the **stock market** in any given day," said N. Gregory Mankiw, a Harvard University economist and former chairman of the president's Council of Economic Advisers under Mr. Bush. "The **stock market** is a leading indicator, albeit an imperfect one. So it is natural to see a rising market as good news. But it is highly speculative to tie a **stock market** movement to any particular set of policies."

While the Dow closed at its lowest point in two months, the market remains well above where it was when Mr. Trump was elected. Even with the loss, the Dow is 23 percent higher than on Inauguration Day 2017 and 33 percent higher than on Election Day 2016.

Over all, the 25 percent increase in 2017 was the largest annual rise since 2013, when the Dow shot up by 26.5 percent. Over the eight years of Mr. Obama's presidency, which began at the depths of a financial crisis and recession, the market rose nearly 150 percent.

After calling attention to the daily running of the bulls for so much of the past year, Mr. Trump chose to focus on other metrics on Monday at a manufacturing plant in Ohio where the company used some of the proceeds from the tax cuts to give employees bonuses.

"Your paychecks are going way up," he told workers. "Your taxes are going way down. And right now, for the first time in a long time -- and you've seen it -- factories are coming back. Everything is coming back. They all want to be where the action is."

At least some of the action, for the moment, will be on the trading floor.

Follow Peter Baker and Binyamin Appelbaum on Twitter: @peterbakernyt @bcappelbaum.

The market dropped sharply again on Monday. The bad news for investors seems to be driven in part by good news for workers. (PHOTOGRAPH BY SPENCER PLATT/GETTY IMAGES) (A14)

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The New York Times

National Desk; SECTA
Slumping Stock Market Greets the Swearing-In Of the Fed's New Leader

By BINYAMIN APPELBAUM
799 words
6 February 2018
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WASHINGTON -- Jerome H. Powell took the reins of the Federal Reserve on Monday with a depleted board and a list of challenges that has suddenly expanded to include a second day of **stock market** wobbles.

Mr. Powell is unlikely to respond to the decline in stock prices unless it worsens dramatically. In remarks after his swearing-in as Fed chairman, he emphasized the health of the economy.

"Today, unemployment is low, the economy is growing and inflation is low," Mr. Powell said in a brief video statement that the Fed published on its website. "Through our decisions on monetary policy, we will support continued economic growth, a healthy job market and price stability."

The **stock market** declined 35 percent in the three months after Alan Greenspan became Fed chairman in August 1987, including the "Black Monday" crash in mid-October. Mr. Greenspan responded by sharply cutting the Fed's benchmark interest rate and issuing a public statement declaring that the Fed was ready and willing "to support the economic and financial system."

The intervention, which reversed the decline, was celebrated at the time, but it contributed to an expectation in **financial markets** that Mr. Greenspan would not allow stock prices to fall.

The current downturn is much smaller. The **Standard & Poor's 500-stockindex** is down 6 percent since Thursday. Mr. Powell said on Monday that the economy is in good health. With unemployment low, the Fed is focused on raising its benchmark interest rates to stay ahead of inflation.

"Powell could have done without a slump in the U.S. **stock market**, but unless the slump becomes a rout, he is unlikely to intervene," wrote John Higgins, an economist at Capital Economics.

The Fed's enforcement action against Wells Fargo on Friday is another new addition to Mr. Powell's plate. The Fed halted the bank's growth until it improves its internal checks and balances, a move that comes as the Fed's seven-member board is down to just three governors, the smallest number in the institution's history.

In addition to Mr. Powell, the members of the board are Randal K. Quarles, the vice chairman for supervision, and Lael Brainard.

Mr. Quarles, who oversees financial regulation issues at the Fed, has recused himself from Wells Fargo-related business because he held significant investments in the firm before he joined the Fed last year. That leaves Ms. Brainard, the other member of the committee that oversees supervision, as the Fed's point person on the Wells case, although Mr. Powell would also participate in significant decisions.

Other Fed governors could be arriving. President Trump has nominated Marvin Goodfriend, a conservative economist, to join the board. He is awaiting Senate confirmation.

Mr. Trump has not announced nominees for the other three seats on the board.

The regulators who directly supervise Wells Fargo are employees of the Federal Reserve Bank of San Francisco, one of the 12 regional banks that make up the Fed system. Before the 2008 financial crisis, the regional reserve banks exercised significant control over the institutions headquartered in their regions. But in 2010, the Fed centralized the regulation of large banks to improve the consistency of regulation and to take a broad view of issues affecting multiple banks.

The judgment about Wells Fargo's progress will be made by a staff committee, the Large Institution Supervision Coordinating Committee, that is led by Michael S. Gibson, the Fed's director of supervision and regulation, in close consultation with the board of governors.

Wells Fargo has been through this process once before. The company was censured in December 2016 for failing to file an adequate plan for dealing with a financial crisis.

Mr. Powell was sworn into office by Mr. Quarles, a longtime friend. When Mr. Powell worked as a senior Treasury Department official under President George Bush in the early 1990s, he hired Mr. Quarles as an assistant. Later the two men worked together at the Carlyle Group, a private equity investment firm.

Mr. Quarles was selected by Mr. Trump as the Fed's point man for an overhaul of post-crisis financial regulations, which the president views as excessive. Mr. Powell on Monday reiterated his view that the financial system ''is now far stronger and more resilient'' as a result of increased regulation and ''we intend to keep it that way.'' He added that there is room for improvement to make regulation ''efficient as well as effective.''

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The Fed's vice chairman for supervision, Randal K. Quarles, left, administering the oath of office to Jerome H. Powell in Washington. (PHOTOGRAPH BY JIM LO SCALZO/EUROPEAN PRESS AGENCY)

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The New York Times

National Desk; SECTA

How Does the Steep Drop In the Market Stack Up?

By STEPHEN GROCER and PETER EAVIS
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There have been far blacker Mondays.

The Dow Jonesindustrial average plunged 1,175.21 points, or 4.6 percent, to 24,345.75 on Monday, while the Standard & Poor's tumbled 113.19 points, or 4.1 percent, to 2,648.94.

Measured by points, those are steep drops -- the biggest on record for the indexes. The previous largest point declines for each benchmark came in 2008, at the height of the financial crisis.

But Monday's plunge was far less impressive on a percentage basis. The Dow's fall ranked as its 100th biggest, while the S. & P. 500's slide was the 127th biggest in the index's history, according to S & P Dow Jones Indices.

Here is how Monday's sell-off stacks up against two other major tumbles.

Sept. 29, 2008

Dow: Down 777.78 points, or 6.98 percent

S. & P. 500: Down 106.85 points, or 8.81 percent

Just weeks after Lehman Brothers failed in September 2008, lawmakers in the House defied President George W. Bush and rejected a $700 billion economic rescue plan. The vote sent markets tumbling to what was the biggest point loss in either index's history.

But points are not the best way to compare the magnitude of a stock index's declines across eras. As the stock market has risen, big point moves have translated into increasingly smaller percentage changes. The Dow and the S. & P. 500 have more than doubled from their closes on Sept. 29, 2008.

Oct. 19, 1987

Dow: Down 507.99, or 22.61 percent

S. & P. 500: Down 57.86, or 20.47 percent

"Black Monday" was a petrifying moment -- an even bigger decline in both points and percentage than the stock market crash of 1929. But unlike the 1929 crash, the slide in 1987 did not contribute to a wider economic slump. The stock market recovered its losses by early 1989.

But the plunge did prompt regulators to introduce special brakes that kick in when the market falls too far, too fast. Stock markets, though, remain vulnerable to the sort of confusion and fear that one prominent economist said last year was a potent force in 1987.

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The New York Times

National Desk; SECTA
Trump Calls Dissenting Democrats 'Treasonous'

By MARK LANDLER; Katie Rogers contributed reporting from Cincinnati.
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WASHINGTON -- President Trump on Monday accused Democrats who did not clap during his State of the Union address of being un-American and even treasonous. His remarks came in a rambling, discursive speech at a factory in Ohio, during which he celebrated his revival of the American economy as the **stock market** plummeted by more than 1,000 points.

''Can we call that treason?'' Mr. Trump said of the stone-faced reaction of Democrats to his speech. ''Why not? I mean, they certainly didn't seem to love our country very much.''

Mr. Trump was speaking during a visit to a company near Cincinnati that makes pneumatic and hydraulic cylinders. The company, Sheffer Corporation, awarded each of its 126 employees a one-time bonus of $1,000 after the passage of the tax cut, and the White House clearly hoped to use it to drive home the message of economic health in last week's State of the Union speech.

''Your paychecks are going way up,'' a beaming president said to this more friendly audience. ''Your taxes are going way down.''

But as Mr. Trump spoke, TV networks broadcast a jarring split screen. While the president boasted of companies bringing billions of dollars back to America, the **Dow Jonesindustrial average** was shedding billions more. At one point, the rout become so drastic that CNN and MSNBC switched from the speech to report exclusively on the market gyrations.

Unlike most of his predecessors, who have generally avoided talking about the ups and downs of the **stock market**, Mr. Trump has repeatedly taken credit for the rise in stock prices. He often mentions the **bull market** in settings that have nothing to do with the economy. But on Monday, he made no mention of it, preferring to focus on other economic indicators, like the unemployment rate and economic growth.

As Mr. Trump patted himself on the back for the tax cut, he went after the Democrats for opposing the $1.5 trillion legislation. He delivered a lengthy digression on the State of the Union address, noting that Democrats sat on their hands as he ticked off one measure of success for the country after another.

''It got to a point where I really didn't even want to look up too much during the speech over to that side because honestly, it was bad energy,'' Mr. Trump said.

''Even on positive news, really positive news like that, they were like death and un-American,'' he said, repeating, ''Un-American. Somebody said treasonous. I mean, yeah, I guess, why not.''

Mr. Trump was clearly also honing his message for the political campaigns to come before the midterm elections in November. He acknowledged that the president's party normally suffers setbacks, in part because its voters become complacent.

But he insisted that Republicans could ride the strong economy to victory this fall, saying Democratic leaders like Senator Chuck Schumer of New York and Representative Nancy Pelosi of California were out of touch with ordinary people.

''They want to raise your taxes,'' he said. ''They don't want to give the money to the military, which we have to because our military -- because of Obama and even beyond Obama -- it's depleted, it's in bad shape.''

Noting Ms. Pelosi's recent assertion that middle-class people would receive only "crumbs" from the tax cut, Mr. Trump said, "This is not a good day for Nancy Pelosi. She's our secret weapon." He added, "I just hope they don't change her. There are a lot of people that want to run her out. She's really out there."

Ms. Pelosi fired back quickly, saying through her spokesman, Drew Hammill, "As the Dow nosedives on his watch, the president's rambling, deceitful tax scam sales pitch reached an all-time low in Cincinnati."

Though Mr. Trump was on an official presidential trip, his visit was replete with political overtones. In addition to Ohio's Republican senator, Rob Portman, the president brought along James B. Renacci, an Ohio congressman who is challenging the state's Democratic senator, Sherrod Brown, this year, with the encouragement of the White House.

"We want to get Jim in it, and a lot of other people in," Mr. Trump said. "But we have to be tremendous."

Gov. John Kasich of Ohio, who challenged Mr. Trump in the 2016 Republican primary race and has remained a vociferous critic, did not meet him.

In a more sedate event nearby, Melania Trump, the first lady, played board games with children at Cincinnati Children's Hospital Medical Center. Mrs. Trump, who accompanied her husband to Ohio after spending much of January relatively out of sight, received a briefing on neonatal abstinence syndrome from physicians, who explained the effects the disease has on infants born with opioid dependency.

When Mrs. Trump visited an infant recovery center last fall in Huntington, W.Va., she said she hoped to "give a voice" to those suffering from addiction.

But while her husband reveled in the back-and-forth with his audience, Mrs. Trump kept her time in front of cameras limited to a few minutes, directing her attention to the children who had been gathered to greet her. She played the game "Sorry!" and handed out valentines, with her signature on the inside.

Follow Mark Landler on Twitter: @MarkLandler.

This is a more complete version of the story than the one that appeared in print.

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THE WALL STREET JOURNAL.
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Markets on Edge: Web Outages Freeze Investors

By Daisy Maxey and Sarah Krouse
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The Wall Street Journal
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A6
English

The websites and mobile applications of discount brokerages, mutual-fund firms and digital advisers suffered outages and slowdowns Monday, unnerving individual investors trying to access their accounts during the market rout.

The trading disruptions occurred as U.S. stocks plunged toward the end of the trading day. The **Dow Jones Industrial Average** closed down more than 1,170 points Monday, its biggest one-day point drop ever, and the **S&P 500** and **Nasdaq Composite** were both off around 4%.

Investors complained online of outages at Betterment LLC, a pioneer in the automated investing world; digital adviser Wealthfront Inc.; Charles Schwab Corp.; TD Ameritrade Holding Corp.; Vanguard Group; and elsewhere.

One firm, T. Rowe Price Group Inc., suffered an outage late in the day before restoring service.

A spokeswoman for the firm said it had "experienced brief accessibility issues on some of its websites" that had been resolved. "We apologize for any inconvenience experienced by our clients," she said.

Alexander Sosnowski, a strategy analyst at Gap Inc. in San Francisco who has a Vanguard account, saw the **stock market** was falling fast at the end of the trading day as he was taking his lunch break. The 25-year-old had cash in his account that he wanted to invest in **S&P 500** stocks and saw a buying opportunity.

"Since it was such a big drop . . . I knew it was an opportunity to take advantage of it," Mr. Sosnowski said. After 20 minutes of trying unsuccessfully to access his account, he called his mother to see if she could log in. When that didn't work, he tried calling the company to execute the trade over the phone, but the call was dropped twice.

Many Vanguard Group customers were unable to log into their accounts Monday afternoon. Several posted on Twitter and on bogleheads.org, a popular online investing forum named after company founder John C. Bogle, that they couldn't see their account balances or trade Monday afternoon.

A spokeswoman for Vanguard said that some clients might have experienced "sporadic difficulty" accessing their accounts at Vanguard.com or by phone.

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REVIEW & OUTLOOK (Editorial)
The Return to Normal Risk

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Jay Powell started work as Federal Reserve chairman on Monday, and stocks promptly fell by the largest single-session point decline on record -- 1175 points, or 4.6% on the **Dow Jones Industrial Average**. No doubt this wasn't anything personal, but the ugly market plunge Friday and Monday is a signal of the trouble Mr. Powell may have unwinding a decade of Fed interference with bond markets to boost risk assets.

The paradox of the **equity-market** correction is that it's taking place even as the real economy looks stronger than it's been since at least 2005 and maybe 1999. The ISM non-manufacturing index for January rolled in at 59.9 on Monday, which means a near-boom in the service economy. The new orders index surged to 62.7 from 54.5 in December and the employment index hit 61.6 from 56.3.

This is the latest signal that the U.S. economy has climbed to a new, higher growth plateau from Barack Obama's secular stagnation. Discounting for noise in the GDP figures, the economy has grown about 3% on an annual basis since last May. Global growth has accelerated to about 4% from 3%, and global trade has revived despite protectionist worries.

With tax reform now kicking in, growth could be even faster in 2018. Business and consumer confidence are higher than they've been in years, and wages are starting to rise at a faster pace amid tight labor markets. The Atlanta Fed's snap GDP calculator, albeit a flighty number, has been signaling first quarter growth above 5%.

So why are stocks falling amid all the good news? The best answer we've heard is that stocks are reflecting a return to **volatility** and risk after years of the Fed's financial repression. With its quantitative easing bond purchases, the Fed has for a decade suppressed market price signals in bonds. The point was to push investors into riskier assets, including equities, real estate, junk bonds, emerging markets, you name it.

This didn't do much for the real economy, which grew more slowly than any expansion in modern times. But it was great if you were lucky enough to hold stocks, amid slow growth, low inflation and low **volatility**. The resulting wealth transfer to the rich from middle-class workers is one reason Donald Trump won the election -- not that he understands this about the Fed. He seems to think interest rates can and should stay low forever.

But they can't, especially when growth is accelerating. Investors may finally be figuring out that the global quantitative-easing monetary party is ending. The Fed has already begun its great unwinding, albeit slowly, but faster growth in Europe and Japan means that their days of central-bank bond purchases also won't last.

This helps explain the sharp rise in the **10**-**year Treasury** yield in recent weeks (before it fell back Monday). The Fed has sat on the long end of the bond market for so long that some investors may not remember normal interest rates when they see them. Investors are adjusting to this new world of faster growth and market-based debt pricing.

After such a long run of rising stock prices and low **volatility**, the correction is all the more abrupt and scary. The rapid intraday price swings are accentuated by trading based on algorithms that also need to be adjusted for new market realities.

Even a substantial price correction shouldn't damage the real economy much after the long market rally since November 2016. A correction of 15% would take us back to prices last fall. The larger risk to the real economy will arrive over time as rates rise and QE unwinds and we see who took on too much risk. We don't know what those asset classes are, but you can bet they'll show up naked on the beach somewhere.

Which brings us back to the unlucky Mr. Powell, who is taking over Fed leadership right when monetary history returns. As Janet Yellen finished her four-year term as Chair last week, she was feted far and wide as a sage leader who presided over financial calm. True enough, but the effusive praise reminds us of the encomiums that attended Alan Greenspan when he left as Fed Chairman in 2006. We know how that story ended two years later.

In the same way, the story of the Ben Bernanke-Janet Yellen Fed won't be written until their unprecedented monetary experiment unwinds. Fed Chairmen don't get credit for only half an economic cycle. Like Presidents on foreign policy, they are responsible for the problems they leave their successors. Mr. Powell's fate, or curse, is that he gets to preside over the return of normal growth and **volatile financial markets**. Good luck.

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The Markets Point Toward Economic Strength

By Jason De Sena Trennert
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The pullback in stocks the past two trading days is both long overdue and healthful. But after nearly a decade of easy money engineered by the Fed and other central banks, is the sell-off in the bond market simply a short-term tantrum? Or is it the start of a secular **bear market** in bonds, due to higher inflation, that can only end in tears?

If one thinks about interest rates as simply the price of money, one could argue that the correction in stock prices would be more worrisome if accompanied by significantly lower bond yields than higher ones. In that regard, higher rates suggest that the economy is no longer so fragile as to require the "extraordinary monetary accommodation" that has kept the federal-funds rate lower than inflation since June 2008.

With the consumer price index running at only 2.1%, higher rates appear to indicate that investors expect a stronger economy and corporate profits rather than impending inflation. The historically modest current increase in the cost of money tends to validate the rally in stock prices since President Trump was elected.

While we all naturally tend to view our most recent experience as typical, the low interest rates some of us have enjoyed since the financial crisis have been anything but normal. They are atypical of a healthy economy that allocates capital properly. Even odder than the low level of interest rates since the "expansion" started in 2009 has been their invariability. Historically, the yield on a **10**-**year Treasury** note has been roughly equivalent to the level of nominal growth in gross domestic product (real growth plus inflation). That would imply that the rates should have averaged 3.4% since 2009 and should be roughly 5% today. Instead they have averaged only 2.45% and are now 2.71%. Why?

The academic economists who have been setting monetary policy would see this as heresy, but there may be a sense in which the best intentions of the Federal Reserve to save the world from the financial crisis at some point started to impede economic progress rather than foster it. More troubling, there is evidence that the Fed's policy mix of easy money and tight financial regulation disproportionately benefited wealthy people with financial assets while hurting poor and middle-class people who earn interest on their savings.

Since the financial crisis, stock and **bond prices** have soared while interest paid on deposit accounts has plummeted. Higher long-term interest rates suggest that investors have come to believe that the outsize influence of global central banks on economic growth is ending. That's good news for those who believe that the collective wisdom of markets, while imperfect, is better at allocating capital than small groups of unelected officials.

Many remain skeptical that the new tax law will spur economic growth. With no reason to think the federal government will curb its profligacy, it is fair to worry about the legislation's long-term impact on interest rates, the deficit and the dollar. In the short term, however, it's best not to overthink it. All historical analogies are imperfect, but the 2003 tax cuts are a reasonable guide to what investors can expect in 2018. Based on that experience, long-term interest rates, earnings and nominal economic growth should all rise this year. If there is any bad news, it is that higher inflation and interest rates are likely to make it harder for earnings multiples to expand, ending the market's ability to outperform the underlying economy as greatly as it has. The good news is that the real economy and corporate profits should boom while a rising and more variable cost of capital should prompt corporations to seek higher returns through capital investment rather than share repurchases.

While free markets can be unsettling, it is difficult to find a lot wrong with the economy today. Consumer spending, capital investment, and government expenditures are rising or likely to rise while a weaker dollar should help offset the trade deficit. These expectations for stronger economic growth are being reflected in long-term interest rates and are currently nothing to fear. Inflationary pressures are likely to build, and the Fed has started the long-awaited process of "normalizing" short-term interest rates.

With liquidity ample and corporate profits set to surge, stock prices should continue to rise. Higher interest rates will temper the urge for investors to pay for growth at any price. In the long run, that is a good thing.

Mr. Trennert is chairman of Strategas, an investment-strategy, economic and policy research firm.

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THE WALL STREET JOURNAL.
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Markets on Edge: Stocks Turmoil Greets New Fed Chairman

By Nick Timiraos
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WASHINGTON -- Jerome Powell spent his first day as chairman of the Federal Reserve sizing up the largest stock selloff in 6 1/2 years and the largest one-day point decline on record for the **Dow Jones Industrial Average**.

The Fed was an indirect player in the recent market tumult. A Friday report of strong January wage gains prompted investor worries that rising inflation would force the central bank to raise interest rates more aggressively than previously anticipated.

Markets had been remarkably placid before last week and with similarly low **volatility** in currency and bond markets. The Fed raised its short-term benchmark interest rate three times last year to a range between 1.25% and 1.5% as the economy strengthened and stocks climbed.

Mr. Powell and his colleagues made no public comment on the selloff Monday and are unlikely to make any sudden moves that could further amplify market **volatility**. The Fed is a glacial institution that doesn't plot rapid changes in course, and he has signaled continuity with the go-slow approach of his predecessor, Janet Yellen.

The stock drop could serve as a healthy correction of asset values that Fed officials have characterized as elevated for several months. This would allow the Fed to stick with its plans to raise interest rates three times this year.

Alternately, if Mr. Powell and his colleagues see the stock selloff as a sign of deeper problems in **financial markets**, they might rethink their policy path.

"When you've had this many years of recovery, normally you would expect at this stage in the cycle imbalances to build," said Dallas Fed President Robert Kaplan in an interview last month. "The next year or two is going to be a period where we need to be on our toes."

When markets fall as they did Monday, the Fed tends to ask two key questions: whether there is a financial stability reason behind the market turmoil, and what a selloff might imply for the economic outlook.

Monday's market gyrations differ in an important respect from those of 2015 and 2016, when similar convulsions prompted Fed officials to delay plans to raise interest rates. Back then, investors worried the Chinese economy and other emerging markets might slide into deflation, with wages and prices chasing each other down.

Now, investors have a wholly different set of worries: that synchronized global growth, tight U.S. labor markets and stimulus from the GOP tax cut could force the Fed to raise rates more aggressively than anticipated to prevent the economy from overheating and sending inflation too high.

"The Fed has been telling us that they want to raise interest rates, and now the data is confirming that interest rates are going up," said Torsten Slok, chief international economist at Deutsche Bank. Riskier assets such as stocks and higher-yielding corporate bonds will be more vulnerable, he said, but despite "episodic bouts of turbulence. . .the underlying economic expansion will continue."

It isn't unusual for new Fed chairs to face tests early in their terms. The October 1987 market crash known as Black Monday, in which the Dow fell 22%, occurred just two months into Alan Greenspan's term. Markets later recovered and the economy expanded solidly.

Stresses in the mortgage market emerged shortly after Ben Bernanke took office in 2006, and he spent most of his two terms in office combating the financial crisis and weak recovery that followed.

The biggest problem for the Fed over the past year has been stubbornly soft inflation, which held below the central bank's 2% target for most of the past six years. One year ago, just as it looked like the Fed might be hitting the goal, a series of one-off price declines, for items such wireless phone plans and prescription drugs, pushed inflation lower.

Officials want inflation to rise to 2%, a level they view as consistent with a healthy economy, but not to shoot much higher. If inflation looks like it's headed too high, the Fed would want to raise rates more than currently planned. But if it looks like falling stock prices and rising bond yields are likely to slow inflation and economic growth, the Fed would likely raise rates less than planned.

If markets stabilize, the movements of recent days might make it easier for Mr. Powell to keep the Fed on the path of gradual rate increases.

"They weren't rooting for this but having markets move in two directions is something they probably see as a sign of a functioning market," said Michael Feroli, chief U.S. economist at J.P. Morgan Chase & Co.

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THE WALL STREET JOURNAL.
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Markets on Edge: Selloff Triggered Confusion, Concern

By Corrie Driebusch and Ira Iosebashvili
314 words
6 February 2018
The Wall Street Journal
J
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English

When stocks were soaring regularly to highs, many traders said they welcomed a healthy pause after such a rapid climb. But the crushing market rout on Monday was far worse than anything they had in mind.

"People have been conditioned to act in a very particular way, and that is to not be afraid of anything," said Jim Strugger, a derivatives strategist at brokerage firm MKM Partners. "In the last few hours, people are kind of waking up to how nasty this can be."

Shortly before 3 p.m. New York time, the **Dow Jones Industrial Average** had slid more than 600 points. Then within 15 minutes it was down nearly 1,000 more points, only to rebound before the close -- a whipsaw move that had echoes of the May 2010 "Flash Crash."

The Dow Industrials closed down more than 1,100 points, or 4.6%, in its largest one-day point decline ever. The two-day percentage decline of 6.76% was the worst for a two-day period since November 2008, in the midst of the financial crisis.

"It's been an ugly two days," said Sahak Manuelian, managing director of equity trading at Wedbush Securities' trading floor in Los Angeles.

On the Stifel Nicolaus trading floor in Baltimore, traders asked one another at what point does a major **stock index** get halted by circuit breakers, said Justin Wiggs, managing director in equity trading at Stifel Nicolaus.

Rules that were adjusted after the 2010 'Flash Crash' dictate a 15-minute halt in all stocks once the **S&P 500 index** falls 7%, which on Monday would have meant a decline of about 193 points to about 2569. The S&P didn't reach those levels on Monday, bottoming at 2638.17.

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The New York Times

DealBook
Business Day; DealBook
Falling Markets Show Trump the Other Side of the Tax Stimulus

By Andrew Ross Sorkin
951 words
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“The **stock market** has smashed one record after another, gaining $8 trillion in value. That is great news for Americans’ 401(k), retirement, pension and college savings accounts.”

That was President Trump only a week ago during his State of the Union address as he triumphantly touted the gains in the **stock market** since he became president.

And then, well, you know. Stocks plunged Friday, and on Monday the market continued to plummet. The Dow fell almost 1,600 points at one point before finishing down more than 1,100 points, or 4.6 percent.

Fingers, of course, are pointing.

The president’s critics have said his decision to tether his success or failure to the **stock market** was ludicrous.

Yes, it was a mistake, but not for the reason you might think.

The reason for the market’s downward turn isn’t that investors believe his stimulus measures, like tax cuts and deregulation, are failing, or might fail.

It is quite the opposite: Investors believe his policies to stoke growth are going to work so well that they will overheat the economy, and force the Federal Reserve to try to slow things down by raising interest rates faster than expected.

Sometimes you can have too much of a good thing. Don’t forget what set off the plunge on Friday: better-than-expected job growth numbers.

It is very possible that by the time election season comes around for 2020, even if this market dip is simply a blip, the economy will be, or will have been, in a recession.

To explain the phenomenon, Ray Dalio, the founder of the largest hedge fund in the world, Bridgewater Associates, imagined the president at the wheel of car.

“Fiscal stimulation is hitting the gas, which is driving the economy forward into the capacity constraints,” Mr. Dalio said. That, he added, “is triggering interest rate increases that are hitting the brakes, first in the markets and later in the economy.”

Before all the pundits pass out from hyperventilating over the market “correction” — and quick fact-check: technically a correction is defined as a drop of 10 percent or more — let’s take a deep breath: The market’s fall may seem precipitous, but it has dipped only 8.5 percent from the top.

That’s certainly significant, especially if you jumped into the market in the last several weeks for the first time. But, in truth, it’s as if we had turned back the clock to where the **stock market** was in the middle of December, when investors — and, yes, the president — were proudly cheering its success.

The market was always bound to turn downward after a record run. Early last week, Peter Oppenheimer, chief global equity strategist at Goldman Sachs, predicted as much, saying, “Whatever the trigger, a correction of some kind seems a high probability in the coming months." He probably didn't appreciate how quickly he would be proved right.

Despite a steady drumbeat of optimism about the economy from top business executives — and rightly so, given the record results they've been producing and expect to produce over the next year — some investors have been quietly suggesting that the market was starting to look expensive when factoring in the likelihood of inflation.

"With the global economy rebounding and resource utilization tightening, we are carefully positioning for the possibility that inflation surprises to the upside," Ken Griffin, a co-founder of the Chicago hedge fund Citadel, wrote in a note to his investors last week.

At the World Economic Forum last month in Davos, Switzerland, chief executives were remarkably optimistic about their own businesses and the economy. But Jamie Dimon, chairman and chief executive of JPMorgan Chase, added a note of caution: Things were going so well, he said, that "I promise you, we are going to be sitting here in a year and you all will be worrying about inflation and wages going up too high."

That optimism may be an economic contra-indicator. "Optimism about global growth is disturbingly high at Davos," Scott Minerd, the chief investment officer of Guggenheim Partners, told Reuters. "While I am of the opinion that the global economy is gaining momentum, I always find it discomforting when virtually everybody shares the same opinion. My fear is that that economic optimism is spilling over into global equities, which will lead to a mania in stocks."

For now, that fever may be breaking, but it is likely to be only temporary. "These big declines are just minor corrections in the scope of things, there is a lot of cash on the side to buy on the break, and what comes next will be most important," Mr. Dalio wrote in a note to his clients Monday.

How long this bull run will continue is anyone's guess, but the betting line is that while it may have another a year or two, it will end.

"History shows that economic cycles exhibit fairly consistent symptoms leading up to a recession," Guggenheim wrote in a note to investors late last year, "starting with a labor market that evolves from cool to hot and a monetary policy stance that progresses from loose to tight in response."

"Our analysis of these metrics suggests that the current expansion will end as soon as late 2019," Guggenheim wrote.

Just in time for the next presidential election.

* Dow Jones and S.&P. Slide Again, Dropping by More Than 4%

Losses shown on a television screen above the floor of the New York Stock Exchange shortly after the closing bell on Monday. | Lucas Jackson/Reuters

Document NYTFEED020180206ee26000dy

The New York Times

Business Day; DealBook
DealBook Briefing: How Monday's Stock Plunge Ranks?

3,070 words
5 February 2018
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Good Monday. Here's what we're watching:

• There have been far blacker Mondays.

• Kenneth C. Griffin is growing concerned about inflation.

• The Fed's regulatory action against Wells may have some bite.

• Broadcom puts more pressure on Qualcomm puts more pressure on

• How worried should JPMorgan clients be about health care?

• How much more will Wells Fargo have to do?

We could use your help: Our colleagues who broke the Harvey Weinstein story are looking at how corporate codes of conduct are changing. Please tell them here , and say we sent you.

There have been far blacker Mondays.

The **Dow Jonesindustrial average**plunged 1,175.21 points, or 4.6 percent, to 24,345.75 on Monday, while the Standard & Poor's tumbled 113.19 points, or 4.1 percent, to 2,648.94.

Measured by points, those are steep drops — the biggest on record for the indexes. The previous largest point declines for each benchmark came in 2008, at the height of the financial crisis.

But Monday's plunge was far less impressive on a percentage basis. The Dow's fall ranked as its 100th biggest, while the **S**. **& P**. **500**'s slide was the 127th biggest in the index's history, according to S & P Dow Jones Indices.

Here is how Monday's sell-off stacks up against two other major tumbles.

Sept. 29, 2008

• Dow: Down 777.78 points, or 6.98 percent

• **S**. **& P**. **500**: Down 106 points, or 8.81 percent

Just weeks after Lehman Brothers failed in September 2008, lawmakers in the House defied President George W. Bush and rejected a $700 billion economic rescue plan. The vote sent markets tumbling to what was the biggest point loss in either index's history.

But points are not the best way to compare the magnitude of a **stock index**'s declines across eras. As the **stock market** has risen, big point moves have translated into increasingly smaller percentage changes. The Dow and the **S**. **& P**. **500** have more than doubled from their closes on Sept. 29, 2008.

Oct. 19, 1987

• Dow: Down 507.99, or 22.61 percent

• **S**. **& P**. **500**: Down 57.86, or 20.47 percent

“Black Monday” was a petrifying moment — an even bigger decline in both points and percentage than the **stock market** crash of 1929. But unlike the 1929 crash, the slide in 1987 did not contribute to a wider economic slump. The **stock market** recovered its losses by early 1989.

But the plunge did prompt regulators to introduce special brakes that kick in when the market falls too far, too fast. Stock markets, though, remain vulnerable to the sort of confusion and fear that one prominent economist said last year was a potent force in 1987.

— Stephen Grocer and Peter Eavis

Kenneth C. Griffin sees warning signs for stocks.

As the U.S. stock markets look wobbly for the first time in nearly two years, at least one major investor is sounding a **bearish** tone.

In a Jan. 31 letter to investors, Kenneth C. Griffin, founder of the Chicago hedge-fund firm Citadel, wrote that even though the broader economic backdrop continues to be positive, he sees several warning signs that could turn stock prices downward.

The end of the Federal Reserve ’s efforts to stimulate the U.S. economy is one factor, Mr. Griffin wrote, that could pressure stocks. But the prospect of inflation, or a rapid rise in the prices of goods and services, is making him especially nervous.

“We are particularly concerned about the nascent signs” of rising inflation in a variety of countries, he wrote. As a result, he added, money managers at Citadel, which runs a variety of hedge funds, are “carefully positioning” for a surprise, sharp upturn in inflation.

Mr. Griffin added that he is also concerned about geopolitical risks, writing that his money managers need to be able to handle negative events if they do occur, “including a trade policy misstep or a military conflict.” He did not elaborate.

In an interview with CNBC in November, Mr. Griffin said the **stock market** was in the “seventh inning” of a rally. He said through a spokesman on Monday that he still thinks there are several innings to go before a downturn begins and that he is more **bearish** on **bond prices** than stocks at the moment.

— Kate Kelly

Here’s a reason to be positive on stocks: Corporate America is reporting strong earnings.

With 50 percent of the companies in the **S**.**&P**. **500** having reported results, profits are on pace to grow 13.4 percent, according to FactSet. If that growth rate holds through the end of earnings, it would mark the third quarter in the past four that **S**.**&P**. **500** companies have reported a double-digit profits increase.

The numbers

•75 percent of companies are reporting earnings above estimates, above the five-year average.

• Companies that are beating estimates are doing so by a 4 percent margin, below the five year average.

•80 percent of companies have reported revenue above estimates, a record high.

• All 11 sectors are reporting earnings growth.

Will Wells Fargo miss out on the banking party?

A Federal Reserve regulatory action, announced Friday evening, placed a cap on the amount of assets (loans and securities) that Wells Fargo can hold. The Fed took this action in response to misconduct at the bank that involved deceiving its customers. The cap will be in place until the Fed is satisfied that the bank has made sufficient improvements in its operations and corporate governance.

Wells Fargo ’s stock is down more than 7 percent Monday, suggesting that investors believe the growth cap will have some bite. With the economy strengthening and interest rates rising, banks can expect to earn higher profits as they make more loans and suffer fewer losses from defaults. Indeed, this optimistic scenario has helped send bank stocks on a tear in recent months. Now, the question is to what degree Wells Fargo will have to sit out the good times.

Wells Fargo executives on Friday suggested that the cap would have limited financial impact, saying it would reduce this year's net profits by $300 million to $400 million, which works out at less than 2 percent of 2017's earnings. One reason the earnings hit might be small is that the bank can stay within the cap by selling short-term, lower-risk investments that don't earn much. Another way the bank intends to limit the negative impact is by reducing the amount of deposits on which the bank pays out a relatively high interest rate.

Crucially, Wells Fargo said that it hopes to increase the size of its loan book. The hope is that, by shedding the low-risk investments, the bank will create the room to make more mortgages, credit card loans and loans to businesses, while staying within the limit.

But it may not turn out to be as straightforward as that.

The growth cap comes after a lackluster year for Wells, which reduced its loans 1 percent last year, compared with an increase of 3.5 percent at Bank of America . Investors waiting for catch-up growth at Wells may have to wait still longer. Also, much depends on whether Wells Fargo can now satisfy the Fed's concerns. Any indication that the bank is struggling to comply with the regulator's demands could set off more turmoil at the bank. There is also a possibility that the tactic of shedding of low-risk investments while making more loans could increase the overall risk of Wells Fargo 's balance sheet.

Brian Kleinhanzl, a banks analyst at Keefe, Bruyette & Woods, wrote on Sunday that the Fed's action will "mean Wells will have a harder time maintaining market share and will have to compete more on price or credit terms versus peers," adding, "Wells will also have to maintain the balance sheet while other banks are growing, and we view this as defensive versus peers."

— Peter Eavis

Broadcom puts more pressure on Qualcomm puts more pressure on

In raising its takeover bid to about $121 billion just now, Broadcom is hoping to allay concerns about its takeover bid and its quest to create a behemoth in computer chips.

What Broadcom is offering :

• A takeover price of $82 a share, up from its original offer of $70

• A "significant" breakup fee if a deal were to be halted for antitrust reasons

• A "ticking fee" that Broadcom would pay in cash if a deal took more than a year to close

It said the new "best and final" offer would be withdrawn if Qualcomm either pushed its annual shareholder meeting back from March 6 (when Broadcom hopes to unseat the entire board) or if it paid more than $110 a share for NXP Semiconductor.

The context: Qualcomm recently reported a 96 percent drop in operating income amid a royalty dispute with Apple. That has given Broadcom some pause, but not enough to make it walk away.

What's next: This offer isn't likely to tempt Qualcomm . It has a better chance of tempting investors, who might then press the chip maker into negotiations.

Stocks aren't the only asset selling off recently.

Bitcoin is down 14 percent Monday to $7,360 . That's a more than 60 percent decline from its high of $19,511 hit on Dec. 8.

Other cryptocurrencies are falling as well. Ripple, Ethereum and Litecoin are all down Monday.

How far can Bitcoin fall?

Simon Tobler, a trader at Swiss-based Crypto Finance AG, told Bloomberg: "If we don't hold the $8,000 level, Bitcoin may fall to $5,000, where the next big support is. The market is lacking big buyers."

How worried should JPMorgan clients be about health care?

Ever since the bank announced a partnership with Amazon and Berkshire Hathaway to create a new health care company, it appears that many have been very worried .

More from Anna Wilde Mathews, Dana Cimilluca and Emily Glazer of the WSJ:

One response: Ultimately, Mr. Dimon, Jeff Bezos and Warren Buffett are working on a sort of group-purchasing venture, according to some of JPMorgan 's bankers. That's far less transformative than some on Wall Street had hoped — or feared.

How much more will Wells Fargo have to do?

On Janet Yellen 's last day atop the Fed (see below), the regulator demanded that Wells Fargo replace four directors and capped the bank's growth. The goal: to send a message .

More from Emily Flitter, Binyamin Appelbaum and David Enrich:

Behind the scenes: Wells Fargo executives were irate that the Fed's announcement trumpeted the replacement of the banks' directors, and that it implied the boardroom changes came at the Fed's instruction.

The big question: Will Wells Fargo have to do more than it just agreed? Gillian Tan of Gadfly suggests that Timothy Sloan, who became the bank's C.E.O. after the scandals, may have to go .

The Washington flyaround

• Paul Ryan deleted a tweet crediting the tax overhaul for a secretary's $1.50-a-week pay raise. He's still being mocked for it. (NYT)

• The federal government is set to nearly double its borrowing this fiscal year, to $955 billion. (WaPo)

• Democrats on the House Intelligence Committee plan to push for the release of their own memo rebutting the one by Representative Devin Nunes about the surveillance of a Trump campaign aide. Mr. Nunes said he, too, had more memos to release .

• Senator Dick Durbin, Democrat of Illinois, said that Congress is unlikely to reach an agreement to protect the immigrants known as Dreamers this week, despite a Feb. 8 government funding deadline. But John McCain and Chris Coons plan on introducing a bipartisan immigration bill anyway.

• Jeff Sessions's silence in the wake of President Trump's attacks on the Justice Department has weakened morale there. (NYT)

Janet Yellen 's exit interview

The now-former Fed chairwoman told PBS NewsHour that while she didn't agree with Alan Greenspan that there were bubbles in the stock and bond markets, she did see reasons for concern .

From her interview with Judy Woodruff:

Already, investors appear more cautious , faced with a tight-looking labor market and central banks potentially preparing to raise rates and take away the easy-money punch bowl.

Today's update: Both Asian and European stock markets continued Friday's declines .

More from Ms. Yellen: She also spoke about being the first Fed chair in history not to be renominated after a full term. “Well, I would have liked to serve an additional term, and I did make that clear. So, I will say that I was disappointed not to be reappointed,” she said.

Starboard attacks Mellanox over stock sales

Starboard Value , the activist hedge fund, has taken up a new line of attack as it pushes for change at the chip maker Mellanox . It is accusing top executives and board members of not having enough faith in their company .

The criticism: Starboard says Mellanox management and directors have sold shares more than 370 times since the company's I.P.O., while buying its shares on the open market just once.

The bigger picture: Starboard is trying to unseat Mellanox 's entire board, arguing that the company needs either to improve its business, including by being more focused in its research spending, or to consider selling itself.

Instead of Viacom , should CBS strike a deal with Amazon ?

Here's a summary of the case for that , put forth by Ed Lee at Recode:

• Getting bigger by merging with another media company doesn't solve CBS 's problems. Selling to a tech giant with great online distribution does more.

• Amazon 's exceptionally deep pockets would let CBS bid for expensive must-watch content like sports rights amid tougher competition.

The very big question: Would Shari Redstone, who with her father controls both CBS and Viacom , allow a deal that didn't involve both companies?

The deals flyaround

• Is debt driving Dell 's deliberations about a potential I.P.O. or deal with VMware? Maybe less than you'd think. (NYT)

• Soho House, the operator of trendy members' clubs, has hired Goldman Sachs and JPMorgan Chase to lead a planned I.P.O. (FT)

• Does the deal boom signal a top for the debt markets? (FT)

• The Carlyle Group , Bain Capital and Apollo Global Management are among those jockeying for Akzo Nobel 's chemicals unit, according to unnamed sources. (FT)

• GlaxoSmithKline and Reckitt Benckiser were the only bidders for Pfizer 's consumer unit, according to unnamed sources. (Bloomberg)

Samsung 's heir walks out of prison

A South Korean appeals court reduced and suspended Lee Jae-yong's sentence for bribery and corruption.

A lawyer for Mr. Lee said that his client would appeal to South Korea's Supreme Court to be declared innocent of the remaining charges. Prosecutors haven't yet said if they'll appeal. But critics of the country's conglomerates had hoped that Mr. Lee's original, unusually long sentence — five years — would herald tougher regulation.

The context: Samsung has done fine with Mr. Lee in jail: Its electronics operation is earning gangbuster profits and its semiconductor business is well positioned to keep minting money.

Where is Bitcoin today?

At $7,783, says CoinMarketCap , down another 12 percent over the past 24 hours. Other big virtual currencies are down, too.

Not helping: Credit card issuers including JPMorgan , Bank of America , Citigroup and Lloyds are now blocking purchases of virtual currency .

How Bell Pottinger, a pioneer of shameless P.R., died

It helped create the template for London P.R. firms catering to foreign governments. But it went bankrupt in a tale of corporate skulduggery — working for the wealthy Gupta family of South Africa and inflaming racial tensions there — that seems lifted from "House of Cards."

More from David Segal of the NYT :

The misconduct flyaround

• Uma Thurman has opened up about what she described as sexual misconduct toward her by Harvey Weinstein. (NYT)

• Five women of different ages and professions gathered to discuss experiences of the gender wage gap: "That was the most humiliating experience that I have ever had." (NYT)

Quote of the day

— J.D. Vance, venture investor and memoirist, in a lunch interview with the F.T.

The Speed Read

• Unilever brought deodorant to China dreaming of a market with 2.6 billion armpits, but struggled against beliefs that it's healthy to sweat. Other companies have hit similar cultural difficulties. (NYT)

• Early employees of Google and Facebook are among the founders of the Center for Humane Technology, which will challenge the companies they helped to build. (NYT)

• Amazon has trained markets to give it leeway. They appear to accept that it has a strategy for Whole Foods that will take time. (NYT)

• New York Times reporters bought the same ingredients for Super Bowl meatballs at a Whole Foods 365 store and a Walmart . Both the price and the outcome were different. (NYT)

• Greg Coffey, the star hedge fund trader known as "the Wizard of Oz" who retired five years ago, is raising $2 billion for a new fund focused on emerging markets, according to anonymous sources. (FT)

Want this in your own email inbox? Here's the sign-up .

You can find live updates throughout the day at nytimes.com/dealbook .

We'd love your feedback. Please email thoughts and suggestions to bizday@nytimes.com .

Drew Angerer/Getty Images | Kenneth C. Griffin | Heidi Gutman/CNBC | The Federal Reserve's actions do not affect Wells Fargo's financial condition, the bank's chief executive said on Friday night. | Matt Rourke/Associated Press | A Broadcom takeover of Qualcomm could be the largest deal in tech industry history. | Mark Schiefelbein/Associated Press | Jamie Dimon is said to have been hitting the phones. | Eric Piermont/Agence France-Presse — Getty Images | Ali Asaei | Lexey Swall for The New York Times | Jeffrey Smith, chief executive of Starboard Value. | Rick Wilking/Reuters | Jeff Bezos of Amazon with, from left, the actors Matt Damon, Taika Waititi and Chris Hemsworth after the Golden Globes last Sunday. | Alberto E. Rodriguez/Getty Images | Dong-a Ilbo, via Agence France-Presse — Getty Images | Uma Thurman in New York. | Damon Winter/The New York Times | J. D. Vance | Naomi McColloch

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Exchange-Traded Funds: Zero-Fee ETFs (or Even Negative) Are Coming --- A professor discusses what could cause the final push past the no-charge barrier in 2 1/2 years or less

By Derek Horstmeyer
998 words
5 February 2018
The Wall Street Journal
J
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English

Corrections & Amplifications

The expense ratio on the iShares S&P 1500 Index Fund declined from 0.2 percentage point in 2011 to 0.03 percentage point this year. The Vanguard **S&P 500** ETF's expense ratio fell from 0.06 percentage point to 0.04 percentage point in the same period. A chart with an article about exchange-traded funds in Monday's Investing in Funds report incorrectly labeled two of the funds as the Vanguard **S&P 500** ETF. A corrected chart is available at WSJ.com/Corrections.

(WSJ February 7, 2018)

(END)

Are zero-fee exchange-traded funds on the horizon in the U.S.?

Between the low overhead costs possible through economies of scale, and the additional income that fund managers can generate by lending securities to short-term borrowers, the barrier could be broken in the next year or two. Even a negative-fee ETF -- where the fund pays investors to invest -- might be possible.

The U.S. ETF industry has grown at an average of more than $100 billion a quarter over the past two years, ballooning into a $3 trillion behemoth. Accompanying this growth in assets under management has been a steady reduction in operating expenses, with numerous brokerage houses now offering annual fees of just 0.03% (technically, 0.03 percentage point) on U.S. market-index ETFs. That's $3 on a $10,000 investment.

What could spark the final push past the zero-fee barrier?

In 2014, Charles Schwab Corp. challenged Vanguard Group's stranglehold on the index-ETF market by reducing its Schwab U.S. Broad Market ETF (SCHB) fee to just 0.04%, kicking the "race to zero" into high gear. This move seems to have paid off for Schwab, with this flagship ETF growing 10-fold over the past four years and nearly catching such industry heavyweights as iShares S&P 1500 Index Fund (ITOT), though both still lag far behind Vanguard's low-fee offering Vanguard **S&P 500** ETF (VOO) in terms of assets.

Competition between these firms has continued to drive down expense ratios. Lee Kranefuss, one of the founders of iShares, has been quoted as saying: "There isn't a 'zero lower bound' to expenses. A negative management fee is certainly conceivable."

With the industry just 0.03 point away from the zero barrier, two forces could push it past: increased inflows of around $900 billion into the ETF index arena (which could happen within the year), or an increase in revenue generation from lending out shares to short sellers.

One of the most salient features of the ETF and index mutual-fund industry is that as more money flows into a fund, the costs of operating the fund decrease.

Let's take a look at the average expense ratio of U.S. index mutual funds over the past 17 years. (Index funds, like ETFs, track indexes, but they have been around longer, making it easier to analyze cost trends.) Based on an analysis of data from Morningstar and the Investment Company Institute, the trend shows that a $290 billion increase in inflows into index mutual funds and ETFs that track indexes drives the average expense ratio of an index fund down by 0.01%.

This implies that one of the current low-fee ETFs could drop its 0.03% expense ratio to zero with as little as an additional $870 billion flows into the index mutual-fund/ETF arena. If current inflow trends continue, this could hypothetically happen within the year.

Another way to analyze this question is to isolate those three very low-cost ETFs -- the aforementioned Schwab, iShares and Vanguard funds -- by expense ratio over time.

Looking at these ETFs paints a similar, though slightly more conservative, picture. If the current assets/expense ratio relationship holds up, one of these ETFs could hit the zero barrier if there is $1.5 trillion more in industry ETF assets (aggregate), or approximately 2 1/2 years at current inflow rates.

ETFs also can generate revenue by lending the shares they hold (or shares of the ETF themselves) to borrowers who want to sell them short in a bet they will fall in price. The funds can make money by charging lending fees, as well as on the collateral that borrowers have to post for the shares they short.

Some funds do more of this than others. For example, while the Schwab U.S. Broad Market fund sat on $10.2 billion in assets in the third quarter of 2017, the fund held collateral for only $36.5 million in assets that it had lent out. This equated to just under 0.3% of its portfolio on loan, generating $100,000 in revenue. That would contribute little to the $3.42 million in annual operating expenses that the fund likely would need to save to operate at cost.

This pales in comparison to the lending behavior of many other ETF providers. For instance, iShares Core **S&P 500 index** (IVV) has averaged a loan rate of 1.5% to 2% of total assets since 2010. This slightly more-aggressive strategy over time has netted it between $1.2 million and $1.8 million a year in shorting fees. If Schwab decided to lend upward of 2% to 3% of its holdings (as opposed to just 0.3%), this could get it well on its way to the $3.42 million in shorting revenue needed to have a sustainable zero-fee ETF.

Charles Schwab Investment Management declined to comment other than to say it reinvests all net lending revenue directly back into its funds. IShares declined to comment.

The path to a zero-fee ETF seems possible with just a bit more time. It may take investors parking an additional $870 billion in the passively managed arena (or roughly $1.5 trillion, if the more-conservative estimates win out), but it appears entirely plausible that a sustainable zero-fee ETF will be offered within two years. Whether Vanguard, Schwab or BlackRock take the victory lap for the first offering remains to be seen.

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The New York Times

Business Day
Dow Jones and S.&P. Slide Again, Dropping by More Than 4%

By Matt Phillips
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Since the global financial crisis a decade ago, a few simple guidelines have helped investors make sense of the markets.

Global growth and inflation will be perpetually weak. Central banks will help by keeping interest rates low. And stocks will almost invariably rise.

The rule book is now changing, a shift that is sending tremors through the **financial markets**. The **Standard & Poor's 500**-**stockindex** fell by more than 4 percent on Monday, deepening its losses from the previous week and erasing its gains for the year. The **Dow Jonesindustrial average** sank by 4.6 percent. Bond yields, the basis for key borrowing costs such as mortgage rates, have risen fast in recent weeks.

In trading in Asia on Tuesday morning, markets signaled another tough day. Major stock markets in the region plunged after the drop in the United States on Monday, suggesting the pain could continue. In Japan, stocks were down more than 5 percent in morning trading, while shares in Hong Kong were down more than 4 percent.

Those sharp moves come as investors digest the growth prospects for the world — and rebalance their views on the relative merits of stashing their cash in risky assets like stocks, safer spots such as government bonds and the myriad investment opportunities offered by a global economy moving in sync.

The world's largest economies are all expanding, as the most important central bank, the United States Federal Reserve, is draining billions of dollars from the financial system and raising interest rates. And investors are concerned that tenuous signs of inflation could mean central banks around the world will start to remove their support even faster.

It's an interesting complexity for investors to assess. What's good for the economy isn't always good for the markets. The strong job report last week fueled hopes that wage growth would follow. But higher wages could lead to higher inflation, creating new challenges for the central bank to manage.

New leadership at the Fed is adding a degree of uncertainty. Jerome H. Powell was sworn in as the 16th chairman of the Federal Reserve on Monday, after the departure of his predecessor, Janet L. Yellen. The markets do not have a clear understanding of exactly how, if at all, Mr. Powell's views on unemployment and inflation will differ from that of Ms. Yellen.

A rocky patch for the markets could become awkward for President Trump. He has repeatedly claimed credit for surging stocks, while business optimism over his push to cut taxes and decrease regulation has helped fuel the "Trump Bump."

While giving a speech during Monday's sell-off, Mr. Trump made no mention of stocks. Afterward, the White House instead extolled the "long-term economic fundamentals, which remain exceptionally strong, with strengthening U.S. economic growth, historically low unemployment, and increasing wages for American workers."

Mr. Trump's habit of regularly boasting about **stock market** surges is a practice other presidents avoided. They knew that what goes up may go down again, and they did not want to take the blame for market forces beyond their control.

Stocks surged broadly during the president’s first year in office. By late January the S.&P. 500 was up 27 percent since Mr. Trump’s inauguration. But the last few days of trading cut those gains to just 17 percent.

“When you get this kind of sell-off, it kind of feeds on itself,” said Michael P. Ryan, chief investment officer for the Americas at UBS Wealth Management.

Although the market opened lower on Monday, it actually had climbed into positive territory in the morning. But the declines snowballed throughout the afternoon. The 4.1 percent drop was the worst for the S.&P. since August 2011.

Back then, the sell-off followed growing concern about a chaotic budgeting process in the United States. A showdown between Congress and the Obama administration over the debt ceiling brought the country to the brink of default. In response, credit rating firm Standard & Poor’s stripped the United States of its triple-A rating, spooking markets.

The economy today is in tricky territory from a markets perspective. Investors have been excited about the prospects of the tax cuts, but they are also fretting that the government may be spending too much to pay for them.

Economists often advise governments to run large deficits during recessions to stimulate growth. But the United States economy is already solid.

It grew at an annual pace of 2.6 percent last quarter. Unemployment was 4.1 percent January.

In essence, the $1.5 trillion tax cut may be stimulus that the economy does not need. The extra money raises the prospect that the economy could overheat, stoking inflation.

“We’re pouring a tremendous amount of fuel on the fire,” said Rick Rieder, who oversees roughly $1.7 trillion in assets as global chief investment officer for fixed income at the asset manager BlackRock.

Global investors are also trying to navigate a changing economic backdrop.

After years of sluggish growth, major economies in Europe and Japan appear to have good momentum. On Monday, an index of eurozone purchasing manager activity, considered a good gauge of growth, hit a 12-year high, suggesting that the surprisingly strong European economy has further room to grow.

Against the strength, investors are wondering whether those central banks will tamp down on their efforts to help growth, which could send interest rates higher. Investors are anticipating that the European Central Bank could pull back, depending on the economic conditions.

The weakness on display in the United States set the tone for foreign markets. Japan’s Nikkei 225 dropped by 2.6 percent on Monday. Benchmark equity indexes in France, Italy and Spain all fell by more than 1 percent.

In the United States, financial stocks endured some of the steepest drops, led by Wells Fargo. After the close of trading Friday, the large lender was the subject of an extraordinary regulatory action when the Fed barred it from growing until it improved corporate controls.

Industrial stocks tumbled 4.5 percent. The aluminum maker Arconic fell 8.9 percent after its earnings failed to impress investors. The company also said it would bolster capital spending to ramp up production.

Likewise, ExxonMobil fell 5.7 percent Monday. The energy giant disappointed investors with its quarterly earnings report last week. The energy sector was one of the worst-performing parts of the S.&P. 500, falling by 4.4 percent.

The corporate environment reflects forces, along with the changing course of global central banks, that could further add to the choppiness of markets.

For example, oil prices have risen as global growth has picked up steam. That encourages energy companies like ExxonMobil to increase investment, as does provisions in the tax overhaul that make capital spending more advantageous. ExxonMobil has said it plans to spend $50 billion on investments in the United States over the next five years.

Those investments could be good business moves and help feed into the broader economy. But they could also send share prices lower in the short term, as investors have become accustomed to companies using investment dollars to buy back their own stock, a popular move for corporations in recent years. Goldman Sachs analysts recently noted that corporations themselves represent the single largest source of demand for stocks in the United States.

Now, the combination of global growth and tax incentives to make capital investments “actually completely changed the paradigm to just borrow to buy back your stock,” said Mr. Rieder of BlackRock.

Peter Baker contributed reporting from Washington.

* Stocks Fall to End a Bad Week, and a Boom Begins to Look Shaky

* Federal Reserve Shackles Wells Fargo After Fraud Scandal

* Trump Tax Cuts and the Economy: Time Will Tell, Maybe

* The Bad News in the Good News

The New York Times | A trader on the floor of the New York Stock Exchange on Monday. The S.&P.’s 4.1-percent drop was the worst since August 2011. | Richard Drew/Associated Press

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THE WALL STREET JOURNAL.
U.S. EDITION

Investing in Funds & ETFs: A Monthly Analysis --- Portfolio Strategy: Sometimes, Less Is More With a Portfolio of Funds --- Some say reasonable returns with low risk and fees can be had with fewer than 5 mutual funds or ETFs

By Dan Weil
1,071 words
5 February 2018
The Wall Street Journal
J
R5
English

Corrections & Amplifications

A number of U.S.-stock exchange-traded funds cost less than 0.05 percentage point a year in expenses. The figure was incorrectly given as 0.5 percentage point in a Journal Report article on Monday about portfolios that hold a small number of funds.

(WSJ Feb. 6, 2018)

(END)

With the number of mutual funds and exchange-traded funds exploding, investors might be tempted to purchase more funds. After all, diversifying a portfolio is a good thing, right?

Yes, but only up to a point. After that point, more can be less. In fact, investors can put together a sturdy, diversified portfolio with fewer than five funds, and for plenty of people, just one will do, some financial advisers and analysts say. The minimalist strategy can provide reasonable returns with limited risk and low fees, they agree.

"Simpler can be better," says Tom Fredrickson, a New York financial planner. "It takes human emotion and behavioral mistakes out of the equation. As people don't have to actively do anything, it benefits them in the long run."

Here are some of the ways to construct a less-is-more portfolio:

-- Target-date funds: An easy way to attain a broad-based portfolio in a single vehicle is through target-date funds, which are common in 401(k) plans. These funds contain stocks, bonds and sometimes alternative investments, such as real estate and commodities -- and the mix is automatically adjusted over time.

A fund's target date corresponds with investors' expected retirement date. The funds begin their life with a heavy concentration of stocks to provide strong returns, and then shift toward bonds later to reduce risk. "These are designed to be the only fund that someone holds, and as a group, they are the single best diversifiers," says John Rekenthaler, vice president of research at investment-information firm Morningstar.

Investors should shop carefully among these funds, because asset allocations and fees vary. Some funds have zero stocks at the target date, while others have a 40% to 50% stock weighting. Vanguard Group, Fidelity Investments and T. Rowe Price all have strong offerings, Mr. Rekenthaler says. He recommends sticking to funds with annual expenses of 0.7% or less.

To be sure, not all advisers are enamored of target-date funds. One drawback commonly cited is that a fund's asset allocation at any given time may not be right for all of its investors.

"The issue I have is that they're cookie-cutter," says Ethan Anderson, a financial adviser at Rehmann Financial in Grand Rapids, Mich. "The funds don't know anything about you, except when you're retiring."

-- One stock fund: Some advisers say investors under 30 can get by with just a single stock fund. That's because over long periods, stock returns are superior to those of bonds. And while stocks often experience periods of volatility, that's of little concern to someone holding an investment for 30 years or more -- so long as you have the risk tolerance to resist selling when the market tumbles.

"If you're more than 10 years from retirement, there's no need to invest in bonds," Mr. Anderson says. Rolling monthly 10-year returns for the S&P 500 were positive 94.6% of the time from January 1926 through December 2017, according to Morningstar. And from 1928 through 2017, the S&P 500, including dividends, generated an average annual return of 9.65%, compared with 4.88% for 10-year Treasury notes, according to data from Aswath Damodaran, a finance professor at New York University's Stern School of Business.

A number of U.S.-stock ETFs cost less than 0.5% a year in expenses. Many advisers cite Vanguard Total Stock Market ETF (VTI) as a solid choice. Some say it's important to own foreign stocks, too, for diversification, and recommend Vanguard Total World Stock ETF (VT).

-- The bond question: Many advisers say the stabilizing effect of bonds is important for all investors. "The maximum I'd recommend is 80% in stocks" for investors of any age, says Harold Evensky, chairman of Evensky & Katz/Foldes Financial Wealth Management in Coral Gables, Fla. It's important to have some money in fixed-income investments, so that when stocks are cheap you can put more in stocks, he says.

Dan Goldie, president of Dan Goldie Financial Services in Palo Alto, Calif., says investors should hold separate funds for stocks and bonds, rather than a balanced fund, which includes both. That's because investors don't have any control over asset allocation in balanced funds. With separate stock and bond funds, "you can balance allocations in the way you see fit," he says. A two-fund portfolio could include Vanguard Total World Stock ETF and Vanguard Short-Term Bond ETF (BSV), Mr. Goldie says.

Keep in mind that not everyone thinks investors should get their bond exposure from mutual funds and ETFs. Interest rates may rise over the next 10 to 20 years, says Mick Heyman, a financial adviser in San Diego. And that would push bond-fund prices down, meaning losses for fund investors.

He says a safer strategy would be to buy Treasurys or certificates of deposit and then hold them until maturity, almost guaranteeing you would receive your principal back.

One enhancer? If you want to go for more than two funds, advisers say you can enhance risk-adjusted returns with a small-cap stock fund and a midcap-stock fund. They have mixed views on the usefulness of an alternative-investment fund.

"It depends on your time horizon," says Karim Ahamed, an investment adviser at HPM Partners in Chicago. Alternative investments whose movements aren't closely correlated with those of stocks and bonds can damp the overall volatility of a portfolio. So if you have an investment you want to cash in five to seven years later -- say, a college-tuition fund -- certain alternatives could be beneficial as a diversifier, Mr. Ahamed says. "But if it's a gift from your parent that won't be touched for 15 to 20 years, it wouldn't provide much benefit." Alternatives funds tend to have high fees and often underperform stocks.

With or without alternatives, a handful of funds or less may be all you need for a healthy portfolio.

Mr. Weil is a writer in West Palm Beach, Fla. He can be reached at reports@wsj.com.

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The New York Times

Op-Ed Columnist
Opinion
Has Trumphoria Finally Hit a Wall?

By Paul Krugman
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When talking about stock markets, there are three rules you have to remember. First, the **stock market** is not the economy. Second, the **stock market** is not the economy. Third, the **stock market** is not the economy.

So the market plunge of the past few days might mean nothing at all.

On one side, don’t assume that there was a good reason for the slide (although the fact that the Dow fell 666 points on Friday hints either at satanic forces or at some mystical link with the Kushner family’s bum investment at 666 Fifth Avenue). When stocks crashed in 1987, the economist Robert Shiller carried out a real-time survey of investor motivations; it turned out that the crash was essentially a pure self-fulfilling panic. People weren’t selling because some news item caused them to revise their views about stock values; they sold because they saw that other people were selling.

And on the other side, don’t assume that the **stock price** decline tells us much about the economic future, either. The great economist Paul Samuelson famously quipped that the **stock market** had predicted nine of the past five recessions. That 1987 crash, for example, was followed not by a recession, but by solid growth.

Still, market turmoil should make us take a hard look at the economy’s prospects. And what the data say, I’d argue, is that at the very least America is heading for a downshift in its growth rate; the available evidence suggests that growth over the next decade will be something like 1.5 percent a year, not the 3 percent Donald Trump and his minions keep promising.

There are also suggestions in the data that risky assets in general — stocks, but also long-term bonds and real estate — may be overpriced. Leaving Bitcoin madness aside, we’re not talking dot-coms in 2000 or houses in 2006. But standard indicators are well above historically normal levels, and a reversion toward those norms could be painful.

About that plummet: If there was any news item behind it, it was Friday’s employment report, which showed a significant although not huge rise in wages. Now, rising wages are a good thing. In fact, the failure of wages to rise much until now has been a deeply frustrating deficiency in the otherwise impressively durable economic recovery that began early in the Obama administration.

But we’re now seeing fairly strong evidence that the U.S. economy is nearing full employment. The low measured unemployment rate is only part of the story. There’s also the growing willingness of workers to quit their jobs, something they don’t do unless they’re confident of finding new employment. And now wages are finally rising, suggesting that workers are gaining bargaining power, too.

Again, this is all good news. But it does mean that future U.S. growth can’t come from putting the unemployed back to work. It has to come either from growth in the pool of potential workers or from rising productivity, that is, more output per worker.

Yet with baby boomers retiring, growth in the U.S. working-age population, especially in prime working years, has slowed to a crawl, while productivity growth has been disappointing. Together, these factors suggest an economy likely to grow only half as fast as Trump promises.

Did the markets believe Trump? At the very least, they've been acting as if the U.S. economy still had lots of room to run; throwing cold water on that belief should mean both higher interest rates and lower stock prices, which is what we're seeing.

But should we be worried about something worse than a mere downshift in growth?

Well, asset prices do look high: A widely used gauge of stock valuations puts them at a 15-year high, while a conceptually similar measure says that housing prices have retraced a bit less than half the rise that culminated in the great housing bust.

Individually, these numbers aren't that alarming: Stocks, as I said, don't look nearly as overvalued as they did in 2000, housing not nearly as overvalued as it was in 2006. On the other hand, this time both markets look overvalued at the same time, at least raising the possibility of a double-bubble burst like the one that hit Japan at the end of the 1980s.

And if asset prices take a hit, we might expect consumers — who have been spending heavily and saving very little — to pull back.

Still, all of this would be manageable if key policymakers could be counted on to act effectively. Which is where I get worried.

It's surely not a good thing that Trump got rid of one of the most distinguished Federal Reserve chairs in history just before markets started to flash some warning signs. Jerome Powell, Janet Yellen's replacement, seems like a reasonable guy. But we have no idea how well he would handle a crisis if one developed.

Meanwhile, the current secretary of the Treasury — who declared of Davos, "I don't think it's a hangout for globalists" — may be the least distinguished, least informed individual ever to hold that position.

So are we heading for trouble? Too soon to tell. But if we are, rest assured that we'll have the worst possible people on the case.

* Dow and S.&P. Drop by More Than 4%, Extending Stock Sell-Off

A television on the trading floor of the New York Stock Exchange on Monday. | Brendan Mcdermid/Reuters

Document NYTFEED020180205ee25003pd

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Challenges Confront Powell as He Takes Reins at Fed

By Nick Timiraos
720 words
5 February 2018
The Wall Street Journal
J
A2
English

The **stock market**'s recent selloff crystallizes three important challenges facing the Federal Reserve's new chairman, Jerome Powell, who takes charge Monday.

Low inflation and steady job gains allowed his predecessor, Janet Yellen, to raise interest rates slowly, enabling the economy to heal and the markets to romp ahead. Mr. Powell takes overamid signs this blissful combination might no longer be possible.

Fed officials raised their benchmark short-term interest rate last year to a range between 1.25% and 1.5% and penciled in three quarter-percentage-point increases this year. Whether Mr. Powell and his colleagues stick to this path largely depends on the central questions that loom ahead.

First, what does the Fed do if the economy gets too hot? Telltales could include unsustainable wage gains and more run-ups in asset values. If the market tumble continues, it could spook investors and turn into more serious turbulence.

The last two economic expansions ended with bursting asset bubbles that triggered recessions in 2001 and 2007.

Those examples are likely front of mind for Mr. Powell, a former private-equity executive who is the first non-economist to lead the central bank in three decades. He is expected to provide continuity from the Yellen era, in part because he consistently voted to support her policies and never voiced public disagreement.

"He understands what cheap money can do in the marketplace," said Steven Blitz, chief U.S. economist at TS Lombard, a research firm. In 2006 and 2007, Fed officials were too slow to recognize bubbles by "narrowly viewing inflation as consumer prices only, and Powell won't do that," he said.

Despite the recent pullback, stocks are up around 3% this year after advancing 25% last year. Adjusted for inflation, the price-to-earnings ratio is nearing all-time highs seen during the 2000 tech-stock bubble.

The Fed has strengthened bank regulation, but its tools to contain wider damage to the economy from bubbles haven't been tested.

Second, officials must decide how to respond to President Donald Trump's $1.5 trillion tax cut.

In the short run, giving businesses and consumers more money could spur demand for equipment, homes and other goods. If the tax cut encourages people to work more andbusinesses to invest more, it could raise the economy's long-term growth rate by increasing the number of workers and the goods and services they can produce.

Either outcome could lead to higher interest rates than now planned. If Fed officials conclude the tax cut is boosting demand without boosting the economy's potential -- for example, because inflation begins rising too much -- the Fed might boost borrowing costs more aggressively.

If it looks like the tax cut is increasing the economy's supply side by generating more investment, the Fed can tolerate faster growth. But higher potential economic growth would boost the so-called neutral federal-funds rate, a level compatible with consistent low U.S. unemployment and steady inflation. This would lead the Fed to raise rates higher than now planned.

Third, what does the Fed do if inflation moves too far above or below its 2% target?

Officials want inflation to rise to 2%, a level they view as consistent with a healthy economy, but not to shoot much higher.

Inflation has been subdued for the past half-decade, perplexing officials who had predicted bigger wage and price increases as the economy expanded.

Price drops last spring for a handful of items, such as wireless-phone plans, led to a string of soft inflation readings. Fed officials said they expected this would prove transitory.

Rising bond yields show investors have started to believe inflation is going to rise and the Fed will have to respond.

But it is too soon for Fed officials to be sure price pressures will keep rising.

Economists at Societe Generale forecast inflation, measured by the Labor Department's consumer price index, to reach 2.4% in the first part of this year, before a deceleration in housing costs drags it down to 1.6% in September. Any inflation softness would complicate plans to raise interest rates and hurt the Fed's credibility.

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THE WALL STREET JOURNAL.
U.S. EDITION

Investors Fear Broader Asset Fall --- As other markets perform in unison, traders fear slide in stocks may spread

By Amrith Ramkumar and Ira Iosebashvili
594 words
5 February 2018
The Wall Street Journal
J
B1
English

U.S. stocks last week suffered their largest weekly drop in two years.

But some investors worry that falling prices for things like oil futures, gold and bitcoin are offering a more ominous signal that could presage deeper declines.

The broad selloff that featured Friday's 666-point tumble in the Dow Industrials marked a sharp reversal from the broad-based advance of the past year.

Many **stock-market** indexes have hit records or recent highs.

The Dow is still up 27% over the past year, while emerging-market currencies, high-yield **bond prices** and commodities like copper and gold have risen as well.

Signs that global growth is picking up while interest rates remain below historical norms have helped propel a broad gain in so-called risky assets. That widespread rally resulted in the average correlation between oil, stocks, bond yields and the euro reaching its highest level in 5 1/2 years, a Deutsche Bank analysis showed.

Even before Friday's stock rout, many global investors had grown uneasy about various assets moving in lockstep -- especially because trading in many of these markets isn't typically tied to share prices.

Such closely correlated movements are often associated with turning points in the markets.

"The market. . .had lost respect for the downside," said Christopher Stanton, chief investment officer of Sunrise Capital LLC. "The idea was that markets could just grind higher."

A sharp rise across asset classes can lead to an increase in leverage, or the use of borrowed money, before a turn in sentiment prompts a decline in prices that spurs forced selling as borrowers scramble to repay obligations.

That has some investors worried that even if some sort of market correction is inevitable, the number of markets that are moving in tandem raises the prospect of a more severe selloff than what the still-positive fundamentals would warrant.

"You're seeing exacerbated moves simply because of crowded positioning," said Michael Hans, chief investment officer of Clarfeld Financial Advisors.

U.S. corporate earnings continue to rise. With nearly half the **S&P 500** companies having reported fourth-quarter results, more than 80% of them have beaten analyst revenue expectations, the highest percentage since at least the third quarter of 2008 when FactSet started tracking the metric. The new tax law is expected to boost profits in the quarters ahead.

Many investors had been hoping for a shakeout that would bring down sky-high valuations.

But others are less sanguine, especially after a **volatile** period for much of the week intensified in a powerful selloff on Friday that wiped out much of January's big gains.

The **S&P 500** closed the week down 3.9% as the **Dow Jones Industrial Average** lost nearly 1,100 points, while U.S. crude and gold also declined. The Stoxx Europe 600 had its worst week in nearly two years, and emerging-markets assets also fell.

"I don't like it," said Mr. Stanton. "I think we're going to see more pressure."

Before last week, the **S&P 500** was up 19% and the MSCI All-Country World Index ex-U.S. was up 18% from the start of July.

The MSCI Emerging Markets Index was up 26%, and major stock indexes around the world were either at or near their highs following one of the broadest January **stock-market** rallies on record.

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The New York Times

The Daily
Podcasts; The Daily

Listen to ‘The Daily’: The Trump Economy

By MICHAEL BARBARO
496 words
5 February 2018
05:58 AM
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English

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President Trump is claiming credit for a booming United States economy.

But is the economy actually booming, and if so, to what extent is the president responsible?

On today’s episode:

• Peter S. Goodman writes about the economy for The New York Times.

Background reading:

• President Trump has claimed responsibility for positive signs in the economy: the **stock market**, jobs, wages.

• The American economy finished 2017 on a firm footing, and it is poised for more vigorous growth.

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Peter S. Goodman contributed reporting.

* How to Join Our Podcast Club

President Trump at Joint Base Andrews in Maryland last week. The American economy finished 2017 on a firm footing, and it is poised for more vigorous growth. How much of that is the result of Trump administration policies? | Al Drago for The New York Times

Document NYTFEED020180205ee2500099

THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- The Surprising Good News About Demographics and The Stock Market --- Millennials could step in for the boomers in the stock market, defying the conventional wisdom -- and boosting equities

By Mark Hulbert
1,014 words
5 February 2018
The Wall Street Journal
J
R1
English

Everybody knows the conventional wisdom that the demographic trend these days is not a friend of the stock market. The baby-boom generation, we've been told, is moving into retirement, and selling stocks in the process.

The conventional wisdom, though, is no longer as accurate as it used to be.

Credit the baby boomers' children, the so-called millennial generation born in the 1980s and 1990s. The millennials are entering the period of their lives in which they increasingly will be investing heavily in the stock market, and according to the leading economic model that relates demographic trends to the stock market, they are a big enough generation to overcome the bearish impact of the baby boomers' retirement. In fact, according to this model, demographics will be a positive for stocks until 2035 (of course, with jarring market declines along the way).

Some might question the validity of this model, put forth in a seminal study in 2002 by a handful of professors in finance and economics. But the model is consistent with the performance of stocks during periods that cover most of the 20th century. And it successfully predicted the relative weakness in stocks for the years from 2000 to 2016.

The performance of stocks from 2000 (when the demographic trends shifted to being bearish for equities) to 2016 (when they shifted back to being bullish) was well below average -- recent all-time highs notwithstanding. Indeed, market strength in recent years only barely made up for the huge losses incurred during the financial crisis and, before that, the bursting of the internet-stock bubble. On an inflation-adjusted and dividend-adjusted basis over that 16-plus-year period, the Nasdaq Composite lost ground. The S&P 500 produced just a 2.7% annualized return.

That S&P 500 return was less than half the stock market's long-term average of 6.9% annualized. There have been only two other times over the past 90 years in which the broad market's average return was this low: the period from 1929 through the mid- to late 1940s (encompassing the Great Depression), and the one between the mid-1960s and the early 1980s (encompassing the 1973-74 bear market and that era's hyperinflation). That is exactly what the demographic model would have forecast.

I wrote a newspaper article about the study soon after it was published, forecasting that the shift in demographics would cause the stock market on balance to struggle until 2016. The study's authors were John Geanakoplos, a professor finance at Yale University, Michael Magill, an economics professor at the University of Southern California, and Martine Quinzii, an economics professor at the University of California, Davis. Though their model is complex, its essence can be distilled to a single number: the ratio of those the authors label as middle-aged (ages 35-49) to those labeled young (ages 20-34).

The model's prediction is that stocks on balance should perform better when this so-called MY ratio is rising than when it is falling. It is this ratio that turned up at the beginning of last year and will continue rising until 2035.

To be sure, the MY ratio in 2035 won't be as high as it was at the height of the internet-stock bubble in early 2000. But Prof. Geanakoplos, in an interview, said that what's important to the model isn't the absolute level of the MY ratio but its trend. And it will be trending upward for the next 17 years.

One thing that could temper this otherwise rosy forecast is the hangover from the Fed's market-supporting bond-buying program, known as quantitative easing, or QE. Prof. Geanakoplos speculated that the stock market between 2000 and 2016 would have performed even more poorly than it did but for QE, which in effect "borrowed" some good performance from the future. If so, then average returns between now and 2035 may be somewhat less than they would have been otherwise.

Another unknown is the effect of international trade. The demographic model historically has worked best in countries for which trade represents a small share of GDP, such as Japan, and least well for countries for which trade represents a big share, such as those in Europe.

The U.S. in this regard is far closer to the Japan end of the spectrum than Europe, but nevertheless trade in recent decades has grown as a share of the U.S. economy.

These qualifications notwithstanding, however, Prof. Geanakoplos still puts stock in the demographic model's forecast that the **stock market** will perform better between now and 2035, on average, than it did between 2000 and 2016.

He emphasized that the model's long-term bullishness doesn't imply that the market will rise in a straight line. There undoubtedly will be one or more bear markets along the way, after all. But it has to be welcome news to investors that demography can now even be considered as a **bullish** prop for equities.

Confirmation that the demographic model is worth paying attention to comes from its success in Japan, a country for which trade represents a small share of GDP and is therefore where the demographic model should be particularly accurate.

Japan's MY ratio has been rising since 2002, and sure enough, the Nikkei Stock Average is nearly triple today where it stood at its 2002 low.

According to Alejandra Grindal, senior international economist for Ned Davis Research, Japan's MY ratio is forecast to continue rising for five more years -- until 2022 -- and then decline for more than a decade.

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The New York Times

Business/Financial Desk; SECTB
As Economy Hesitates, Powell Rises To Lead Fed

By BINYAMIN APPELBAUM
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1
English

WASHINGTON -- Jerome H. Powell, who will be sworn in Monday as the Federal Reserve's 16th chairman, is stepping into his new role as a half-decade of economic tranquillity is beginning to show some signs of strain.

The Fed has gradually been increasing interest rates to maintain control of inflation, and markets are starting to notice. Stock prices fell Friday as investors contemplated higher rates with a tightening labor market.

Mr. Powell, charged with keeping the economy in the safe space between overheating and recession, arrives on that high wire as a relative unknown. He is a lawyer by training and an investor by trade in a role reserved almost exclusively for economists in recent decades.

He has said that he plans to continue the Fed's gradual retreat from the economic stimulus campaign it mounted after the 2008 financial crisis, and markets have taken him at his word.

It is harder to predict how he would respond to faster growth -- or to a financial crisis.

But Mr. Powell, who turned 65 Sunday, arrives in the job with a deeper knowledge of **financial markets** than his recent predecessors, and what friends describe as strong political instincts.

''I worry not at all,'' said Seth Carpenter, who worked with Mr. Powell at the Fed and is now the chief United States economist at UBS. He said that Mr. Powell, in his early days at the Fed, would pull staff members aside after meetings with long lists of questions. In time, the lists got shorter.

''It got increasingly deep and increasingly technical and increasingly sophisticated to the point where I think that this idea that he's not a real economist is just bunk,'' Mr. Carpenter said.

Louis Crandall, a longtime Fed watcher at Wrightson ICAP, said every Fed chief faced unexpected challenges. In 1987, the **stock market** crashed two months after the installation of Alan Greenspan as Fed chairman. Mr. Greenspan was one of the nation's most prominent economists, and his views were well known, but Mr. Crandall said no one had asked what he'd do about a market crash.

Mr. Powell also has well-established views on financial regulation, a crucial issue as the Trump administration seeks to loosen the strictures imposed on the industry after the 2008 crisis.

In the fall of 1991, Mr. Powell, then an assistant Treasury secretary, was summoned before Congress to explain how the government had failed to prevent an elaborate scheme by a bond trader at Salomon Brothers to corner the market in some Treasury securities.

Under sharp questioning, Mr. Powell resisted demands for a regulatory crackdown. He pressed for Salomon executives to lose their jobs, and he favored changes to prevent any recurrences. But he cautioned Congress against meddling with a market that mostly worked.

In October, shortly before Mr. Powell was nominated as chairman of the Federal Reserve, he told an audience of bond traders that he remained proud that the government had shown restraint.

''Regulation should always take into account the impact that it has on markets -- a balance that must be constantly weighed,'' he said. ''More regulation is not the best answer to every problem.''

In his remarks, Mr. Powell also highlighted the importance of **financial market** participants holding each other to a high standard. That approach was reflected in Friday's announcement that the Fed was slapping sanctions on Wells Fargo for failures of corporate governance. The action was taken during the final hours of Janet L. Yellen's tenure as Fed chairwoman, but with Mr. Powell's full support.

Mr. Powell has emphasized the importance of oversight by bank boards of directors, and the Wells action criticized the company's board for failing to do its job. The Fed also published harshly critical letters to the last two chairmen of the Wells board, holding them accountable for the problems.

Mr. Powell is a lifelong Washingtonian. He went away to college at Princeton but came back to law school at Georgetown. He went away to work on Wall Street but came back in the early 1990s to take a job under Treasury Secretary Nicholas Brady, who had also been his boss at the white-shoe investment bank Dillon Read.

Mr. Powell has the calm and unassuming manner of a person confident in his abilities. Mr. Carpenter said the only time that he had seen Mr. Powell show irritation was when he persisted in addressing Mr. Powell as "Governor Powell" rather than "Jay."

John Dugan, a longtime friend who worked for Mr. Powell at Treasury, said Mr. Powell's success owed much to playing well with others. "He has a tremendous sense of humor, but not an unkind one," said Mr. Dugan, a former comptroller of the currency.

The Salomon scandal began with a routine phone call. At the time, Wall Street firms wrote bids on scraps of paper stuffed into a wooden box. The New York Fed policed the process by calling a small selection of buyers to verify bids. In the spring of 1991, a staff member reached a surprised supposed bidder. A quiet investigation found that Salomon was bidding in other peoples' names. No firm was allowed to buy more than 35 percent of a given debt issue; at one auction in May 1991, Salomon bought 94 percent, allowing the firm to resell at a premium.

Mr. Powell oversaw the government's borrowing program, so he led the repairs, including the negotiations over a long weekend in August that resulted in the departure of Salomon's top management and the installation of Warren E. Buffett as chairman. The bond trader went to prison.

Mr. Powell "was impressive to me because he thought clearly and he didn't jump to conclusions," said Deborah A. Perelmuter, then the head of the domestic trading desk at the New York Fed, who watched Mr. Powell hammer together a consensus on the necessary changes -- including the replacement of paper slips with electronic bidding. "He seemed to have his head on straight."

His views about regulation remain substantially unchanged. He supports the stronger rules imposed on financial companies after the 2008 crisis, but he has said he sees room for streamlining and he favors measures that encourage the industry to take responsibility for its conduct, where possible.

After leaving Treasury, Mr. Powell remained in Washington and made a fortune as a private-equity investor at the Carlyle Group. By 2010, he was looking for a new challenge, and he joined the Bipartisan Policy Center for an eight-week project simulating a state's insolvency. He was not paid.

Searching for an encore, Mr. Powell recognized, earlier than most, that the Tea Party Republicans who arrived in Congress in January 2011 were genuinely opposed to raising the nation's borrowing limit, known as the debt ceiling. Since he had been in charge of government borrowing, he also understood, better than most, that default would cause a crisis.

Working by hand, he modeled the government's cash flows, calculating when Treasury would run out of money. He called it the "X date," coining a term that remains in common use. He published his analysis online and, for several weeks, no one paid any attention. Then, quite suddenly, he found himself in the spotlight. Treasury had published its own calculations but the media -- and congressional Republicans -- wanted an independent source of information. All the better that Mr. Powell was himself a Republican.

"Jay was somebody who they could trust, who could help get facts into the discussion." said Shai Akabas, the director of economic policy at the Bipartisan Policy Center, who worked for Mr. Powell as an analyst at the time. "He likes to earn your respect by working hard. It's not about saying, 'I'm here to help.' It's showing them that you're really there constructively."

Mr. Powell started briefing individual members of Congress about the need to raise the debt ceiling and in mid-June briefed the entire House Republican caucus, explaining that failing to act would cause a lot of pain for a lot of people.

When Republican leaders met with Timothy F. Geithner, the Treasury secretary, to negotiate a deal, they mentioned that Mr. Powell's presentation was a crucial reason they would be able to rally the necessary votes to raise the ceiling.

Mr. Geithner asked Mr. Powell if he would be interested in returning to public service. In December 2011, President Barack Obama nominated Mr. Powell for a seat on the Fed's board of governors.

Mr. Powell, who lives in Chevy Chase, Md., with his wife, Elissa Leonard, a filmmaker, is now preparing for a new challenge. One looming test: He has often commuted to the Fed on his bike, an eight-mile ride. He is trying to persuade his new security detail to let him stay in the saddle.

Follow Binyamin Appelbaum on Twitter @bcappelbaum.

Jerome Powell's views on regulation stem from a deep knowledge of **financial markets**. He supports a gradual retreat from the Fed's economic stimulus campaign. But it is harder to predict how he would respond to faster growth -- or to a financial crisis. (PHOTOGRAPH BY LEXEY SWALL FOR THE NEW YORK TIMES) (B7)

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Energy Sector Tumbles by 4.1%

By Ben Eisen
185 words
5 February 2018
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B10
English

Energy stocks had their worst session in more than two years on Friday, leading the market lower.

The **S&P 500** energy sector fell 4.1% on Friday, nearly double the 2.1% drop in the broader index, with all 32 companies in the sector in the red.

Exxon Mobil Corp. fell 5.1% and Chevron Corp. sank 5.6%, both marking their biggest percentage declines since 2011. Both of the energy companies delivered results that missed expectations before the market opened Friday, despite **oil prices** that have generally been rising.

The news, along with a 1% fall in **oil prices** last week, helped weigh on the entire sector.

Freeport-McMoRan Inc. dropped 7.6%, Hess Corp. declined 5.5%, and Noble Energy Inc. was down 5.5%.

The losses for the **S&P 500** energy sector nearly erased its year-to-date gain. The two oil majors also weighed on the **Dow Jones Industrial Average**, together accounting for 79 points of the Dow's 666-point decline.

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Volatility Makes Return to Markets

By Gunjan Banerji
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Market volatility has emerged after a prolonged stretch of quiet.

Since the start of 2018, turbulence in stocks, bonds, commodities and currencies has increased -- a distinct shift from last year, when calm dominated markets.

The Dow Jones Industrial Average tumbled more than 650 points Friday, capping its worst week since January 2016. A measure of expected stock volatility dubbed the Cboe Volatility Index, or VIX, jumped to 17.31 and settled at its highest level since November 2016, a time when jitters surrounding the U.S. presidential election roiled markets.

A yardstick of Treasury market volatility climbed to a six-month high Thursday, Thomson Reuters data show, while a gauge tracking currency swings also has risen sharply.

The resurgence of volatility could create problems for some who have become accustomed to muted moves in prices.

For instance, the recent turbulence was a blow to the wildly popular short volatility trade, in which investors bet on stocks to remain subdued through exchange-traded products or derivatives. The trade got crushed in January for the first time in months.

Of the investors betting against volatility, "those people are getting hurt. There's no doubt about that," said Jerry Lucas, a New York-based managing director at UBS Wealth Management.

Friday's moves arrived after a period of tumult that started in January. During the month, a measure of stock volatility jumped even as the S&P 500 climbed more than 5% -- a development that hasn't happened to that degree in 14 years.

One of the biggest changes that has sparked this bout of volatility has been in interest rates. The yield on Treasurys maturing in two years hit the highest level in almost a decade on Thursday, as signs of inflation have started to creep up after years of price gains being subdued.

Higher rates spell potential bad news for stocks and emerging markets. Stock dividends compete with bond yields as income for investors, while rising interest rates usually portend higher borrowing costs for developing economies.

It also means the U.S. Federal Reserve may tighten monetary policy at a faster clip. Penn Mutual Asset Management portfolio manager Zhiwei Ren warned that that would ripple across markets.

Signs of economic growth raise the stakes for the Fed's every move, Mr. Ren said, making the potential for missteps greater. How to manage a more heated economy is "a more challenging task for the Federal Reserve," he said. This "justifies higher volatility."

The jump in turbulence comes after stock markets have been on an extended tear. The S&P 500 in January posted its longest streak of monthly gains in almost six decades. Ten-year Treasurys just finished the most tranquil year in almost four decades as yields remained low, keeping bond prices high.

"That kind of market is coming to an end," said Mr. Ren. "People are starting to realize that the fundamentals are changing."

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Analysis: Market Gauge Flashes Yellow

By Spencer Jakab
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Is this the top?

Following a 1,096-point weekly decline in the Dow Jones Industrials that culminated in the largest one-week point drop since late 2008, it is natural to ask. The question, however, isn't particularly helpful.

Investing legends who have built vast fortunes by patiently harnessing the magic of compound interest have said that ad nauseam. Not only are the market's turning points unknowable but just trying to guess them is dangerous. Mutual-fund manager Peter Lynch warned that "far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

This is more than folk wisdom from someone with a lot more money than most of us. Studies routinely show that individual investors lose more than a percentage point a year through timing errors. The months when retail investors lag behind the market the most tend to be when stocks are the most **volatile**, suggesting they have sold at inopportune times.

The smart approach centers on regular portfolio rebalancing. The key is to do it on an arbitrary date rather than when we are feeling fearful or greedy, since human instincts are often wrong. Services like robo advisers or target-date funds will implement this mild form of market timing in a cheap and tax-efficient way.

But is the "rebalance and forget it" approach the best possible one? Not necessarily, and this might be one of those times when it pays to take more chips off the table than usual. While there was plenty of anecdotal evidence in recent months that the **stock market** was frothy, there are objective ways of measuring that.

One more reliable than most is the cyclically adjusted price/earnings ratio popularized by Yale professor and Nobel Prize winner Robert Shiller. Less prone to distortion than short-term valuation measures since it spans a decade and adjusts for inflation, the measure shows that U.S. stocks have been more expensive than today only about 2% of the time going back to 1881. Even after Friday's 666-point tumble, stocks are pricier now than before the Great Crash of 1929.

While Mr. Shiller himself cautions that his P/E ratio is no market-timing tool or crash indicator, he says it explains about one-third of future U.S. stock returns. The **S&P 500** has notched an annual five-year total return, reflecting price gains and dividend payments, of negative 0.4% on average when the Shiller P/E was in the highest 10% of readings historically, as it is now, and positive 16.2% following the lowest tenth of readings.

While that difference is huge, reacting to valuation reeks of market timing to many in the buy-and-hold crowd. One exception is Elm Partners, which offers low-cost, tax-efficient passive investment like a robo adviser but with an eye on the riskiness of stocks. Chief Executive James White says Elm's allocation to U.S. equities is now just 18% compared with a base level of 38% because of their own value measure, which is similar to the Shiller P/E.

Calling the top is nearly impossible, but calling markets toppy and reacting accordingly may not be.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Fixed-Income Investing: The Ins and Outs of 'Unconstrained' Bond Funds

By Bailey McCann
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Bond investors have had a rough start to 2018. Bond yields are up, prices are down and inflation worries have risen after Friday's jobs report. And the Fed is expected to raise interest rates at least three times this year.

In this environment, some investors might be tempted to take a closer look at "unconstrained" bond funds, which claim to offer a hedge against rising rates and inflation. These funds take a "go anywhere" approach to the credit markets, meaning they invest opportunistically -- taking both long and short positions -- to achieve a predefined return objective.

The problem, some experts say, is that unconstrained bond funds aren't always easy to evaluate. Some hold a mix of debt, including Treasury bonds, corporate bonds and loans, while others focus only on mortgages. Others may claim to be unconstrained, but have only a sliver of high-yield, or junk, bonds in what is otherwise a vanilla Treasury portfolio. Because they don't invest in the same types of securities and aren't tied to a benchmark such as the Barclays Aggregate Bond Index, comparing them can be a challenge.

What's an investor to do?

"The thing investors must understand is that there are only two types of credit investments -- you're either taking interest-rate risk or you're taking credit risk," says Thomas H. Atteberry, who manages FPA New Income Fund (FPNIX), which seeks an absolute return by investing in asset-backed securities, corporate bonds, municipal bonds and U.S. Treasury bonds. "If you don't think you are going to get paid to take interest-rate risk, then you might look at an unconstrained fund. From there you have to decide if you agree with the fund manager's view of what credit risk you're going to get paid for over the near term."

Unconstrained bond funds may not be comparable to the Barclays index, but Mr. Atteberry says there are guideposts that investors can use to get a sense for how unconstrained funds might react to changes in the market.

One suggestion is to look at how the fund performed during 2013's "taper tantrum," when yields surged on news that the Fed was going to slow down its bond-buying program. "If you look at how these funds did in 2013 around the tantrum, or more recently in the last quarter as yields have gone up, you can start to get a sense for what you might expect as rates rise," Mr. Atteberry says. Investors also should look at leverage and the amount of turnover in a fund's portfolio. "To me, it's hard to make the case that you have done a lot of work on security selection if you're running a huge portfolio that turns over frequently," he says.

Greg Parsons, the chief executive officer of New York-based Semper Capital, says investors also should examine whether the fund manager's decisions reflect what the fund says it invests in.

"What investors should be pressure-testing is if a prospectus says a manager invests in X, is the manager actually invested in X," he says. And as always, the managers should be able to explain what the specific value of an investment is and why the credit risk is worth taking. Semper MBS Total Return Fund (SEMMX) is part of the unconstrained category and focuses on mortgage-backed securities.

With interest rates likely to rise over the next several years and a more-**bearish** outlook for U.S. Treasurys dominating the headlines, some argue that there is a long-term case for a more-flexible approach to credit investing.

"Diversification is important, and [nontraditional credit] assets can provide incremental yield to a portfolio over the long term," says Joseph Barrato, CEO and director of investment strategies at Arrow Funds, based in Olney, Md. Arrow Dynamic Income Fund (ASFFX) invests in high-yield bonds, credit defaults and Treasurys.

Still, some fund managers say that finding value won't be easy in this environment. Kathleen Gaffney, who manages Eaton Vance Multisector Income Fund (EVBAX), says she has started looking globally at emerging-markets bonds because those markets are earlier in their credit cycles than the U.S.

Unconstrained managers are broadly positive on mortgage-backed securities as U.S. housing continues to rebound. Stephen Kane, group managing director, fixed income, at Los Angeles-based TCW, sees a strong runway for growth in legacy mortgage-backed securities, which consist of loans made before the financial crisis that are nearing maturity. TCW's MetWest Unconstrained Bond Fund (MWCIX) is almost 40% invested in the MBS market.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- International Investing: Robo Advisers Start To Take Hold in Europe

By Gerrard Cowan
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The European robo-adviser market is a long way behind its U.S. counterpart. But it is growing fast.

Robo advisers are algorithm-based digital platforms that offer automated financial advice or investment-management services. They usually use exchange-traded funds in stocks or bonds for portfolio construction, though human advisers often remain involved in the advice or investment process to varying extents.

Estimates differ, but according to TechFluence, a technology research firm with offices in Frankfurt and London, the European market had assets under management of about $3.5 billion at the end of 2017. That compares with an estimated $200 billion to $250 billion in the U.S., according to Burnmark, a fintech research firm. Estimates of the number of services range from 98 to 126 in Europe, compared with about 200 in the U.S.

The European side is growing rapidly, says Michael Mellinghoff, managing director at TechFluence. The number of robo-adviser services is expected to grow to around 500 by 2022, he says.

"It's a bit like a second ETF story," he says. "ETFs went after actively managed funds. Now we have robo advisers that target actively managed funds and wealth managers."

Robo advisers are generally far cheaper than traditional financial advisory services, as everything is done online. This also makes them easy to access. The cost of entry is also much lower: generally 5,000 euros to 10,000 euros (about $6,200 to $12,400), versus hundreds of thousands at least for a discretionary service through a bank, says Timo Pfeiffer, head of research and business development at Solactive AG, an index provider that has researched the growth of robo advisers in Europe.

Two markets dominate the growth of the trend in Europe: the U.K. and Germany. While the British market is the largest by assets under management, Germany is having the fastest growth, says Mr. Mellinghoff.

The low-interest-rate environment is a driver, he says. This has a particular impact in Germany, traditionally a market of strong savers. As the interest from bank deposits becomes negligible or even negative, demand is growing for investment services, with robo advisers providing an inexpensive and convenient platform.

"If people have to pay interest, which is happening with a number of banks in Germany, then they are likely to accept at least a low level of risk and move toward investing," he says.

This has led to a number of banking groups preparing robo-adviser offerings, Mr. Mellinghoff says. One example is Comdirect, a subsidiary of Commerzbank, which launched a robo-advisory platform in May. This service, called Cominvest, had gained assets of more than 200 million euros as of end of December and is expected to grow rapidly in the coming years, says Sabine Schoon, head of corporate strategy and consulting at Comdirect.

The European market has also attracted interest from major U.S. providers; BlackRock Inc. announced in June 2017 that it was taking a minority stake in Scalable Capital, a robo-adviser specialist that operates mainly in the German and British markets.

Scalable Capital was founded in 2014 and has been open to investors since 2016. It now has assets under management of more than 600 million euros, making it the second-largest robo-adviser service in Europe, behind U.K.-focused Nutmeg. Scalable Capital's products are also available in Austria and Switzerland, and the company has plans to move into other European countries, says U.K. Chief Executive Officer Simon Miller.

Mr. Miller expects the market to expand quickly in the coming years, as large banks and other well-known names ramp up their own offerings.

"It almost feels like the coming of age for robo advice, because all of the incumbent firms have woken up to it," he says.

There are significant differences between the retail investor markets in Europe and the U.S., says Shaun Port, chief investment officer of Nutmeg. His firm roughly doubled its investor base in 2017, reaching more than 50,000 investors and assets of more than GBP 1.1 billion ($1.55 billion). However, this is "relatively small in the U.S. context," he says, something he attributes to lower demand for self-directed investing in general and for ETFs in particular.

"The concept of using ETFs is still very new here," he says, though he expects their market penetration to greatly expand in the years ahead.

There are numerous other differences between the U.S. and European markets, says Solactive's Mr. Pfeiffer. For a start, the average robo-adviser offering in the U.S. is less expensive than European products, partly because ETFs themselves are less expensive in the U.S.

Additionally, European and U.S. robo advisers behave differently. In a recent report, Solactive published research that showed the average U.S. robo adviser leans more toward stocks than its German equivalent, which has a stronger preference for fixed income. The services also demonstrated a home bias, with investments weighted toward their domestic markets.

This comes down to the way the robo advisers are designed, says Mr. Pfeiffer; for example, a U.S. service is likely to have a higher exposure to the **S&P 500**. Additionally, the designers might build certain restrictions into the models -- in terms of exposure to stocks and fixed income and so on -- that reflect a particular investment culture.

Automation is likely to play a growing role in financial advice in the future beyond simply the choice of investment, says Tony Gillett, director, enterprise platform, at financial services firm Morningstar in the U.K. Still, its potential should not be overplayed, he says: While it can help financial advisers, it is unlikely to ever entirely replace them.

"Automation is going to have a big impact on many aspects of our financial lives, but at the same time, it's easy to overhype," he says. "People will still want elements of human contact. Automation will need to complement this rather than replace it."

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Need To Know: The Benefit of Buying Both the Best and Worst --- Exchange-traded funds make it easier to follow a 'barbell' strategy

By Simon Constable
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English

Should you invest in last year's underperformers or continue with last year's winners? The answer is yes, according to a recent analysis.

Buying both the top three and bottom three market sectors in terms of the prior year's performance is known as a barbell strategy -- a strategy that has been made easier to follow thanks to the plethora of exchange-traded funds. An investor who followed a barbell strategy over the past 25 years would have beaten the broader market and done better than an investor pursuing either individual strategy alone.

Both individual strategies -- buy the worst or stick with the best -- have adherents in the investing world. Buying the worst performers involves buying stocks that are beaten down, in the belief they are poised to bounce. Sticking with the winners is a strategy centered on momentum -- the idea that rising prices tend to attract buyers until something stops that from happening.

But by combining the two methods, an investor can do even better, a new analysis shows. Such a strategy followed each year from 1991 through 2017 would have returned a compounded 10.7% including dividends, versus 10.3% for the **S&P 500**. It also would have made money 78% of the time, according to the analysis conducted by Sam Stovall, chief investment strategist at research firm CFRA in New York. The best and worst sectors were allocated 50% each and rebalanced each year. Taxes and transactions costs aren't included.

"It's called winning through compromise," Mr. Stovall says.

He notes that buying the three winning sectors and sticking with them would have beaten the market 63% of the time and yielded compounded returns of 10.3%, in line with the **S&P 500**. The strategy to buy the three worst sectors would have produced compounded returns of 10.4%, but beaten the market only 44% of the time over the same period.

The combination of the two produces something even better. "When one part zigs the other zags," he says, referring to the idea that the performance of each part of the strategy isn't correlated, smoothing out overall returns.

While the difference in percentage returns (at four-tenths of a percentage point) seems small, the nature of compounding means that it adds up. Investing $10,000 in the barbell approach for 30 years would produce $22,000 more than would investing the same amount in the **S&P 500**. Again, taxes and transactions costs aren't included.

"A barbell approach makes an awful lot of sense," says Chris Bertelsen, chief investment officer of Aviance Capital in Sarasota, Fla. "If you just have a portfolio that is loaded with everybody's favorites, then it is either too late or getting too late" to see a lot of gains, he says.

Investors should note that a barbell strategy is riskier than investing in a broader basket of stocks.

"Anytime you deviate from a diversified portfolio, or you deviate from holding investments in the 11 economic sectors, then you will have a concentrated portfolio," says Vinny Catalano, global investment strategist at Blue Marble Research. "This is closer to what investors like Warren Buffett do. He doesn't have a diversified portfolio and is making big sector bets."

That said, investors might need a strong stomach to tolerate the **volatility** of a barbell strategy. Sometimes there will be years when buying into one of the worst or best categories will create immediate losses. For instance, in 2007 the financial-services sector was the worst-performing group, down 18.6%. In 2008 it stayed at the bottom of the pack, losing a further 55.3%, according to total-return data from Novel Investor. Likewise, energy was the best performer of 2016 but the second worst a year later.

"Even if you have something that works, it won't work all the time," says Mr. Catalano. "If it works 70% of the time," he says, "then you are doing great."

For fund investors interested in creating a barbell portfolio, last year's three worst-performing sectors in the **S&P 500** were telecom (which includes phone companies), energy (which includes oil drillers) and real estate, according to data from Novel Investor. The best three were technology (which includes Apple), materials (such as mining firms) and consumer-discretionary stocks.

The seemingly ever-increasing variety of low-cost specialty ETFs makes it easier for fund investors to follow the strategy analyzed by Mr. Stovall.

For instance, Energy Select Sector SPDR (XLE) tracks energy-sector stocks and has annual expenses of 0.14%. There are many other sector ETFs, as well. What's more, some broker web platforms allow commission-free trading of some ETFs, so the transaction costs may not be a problem if you can find the right sector funds.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Spotlight / PNC S&P 500 Index Fund: An Index Fund's Sudden Death

By Daisy Maxey
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English

Investors in PNC **S&P 500 Index** Fund (PIIAX) late last year may have expected to continue reaping gains similar to those of the steadily rising **stock market**. Instead, they received a hefty capital-gains payout followed by the fund's liquidation.

Their plight illustrates the toll that redemptions can take on investors who stick with a mutual fund as others leave.

The fund gained 22.4% over the one-year period through the end of November, compared with the **S&P 500**'s 22.9% return, according to Thomson Reuters Lipper data. But investors pulled $63 million from the fund, or 38% of its assets, over the 12 months through Sept. 30, research firm Morningstar estimates. With a net expense ratio of 0.44%, the fund was likely pressured by lower-cost competitors, including ETFs, says Mark Wilson, president of Mile Wealth Management in Irvine, Calif.

The redemptions forced the sale of assets by the fund's managers, resulting in a potentially taxable capital-gains distribution to remaining shareholders of nearly 22% of the fund's net asset value in December. The big payout, an unusual event for an index fund, was followed by even more bad news: PNC liquidated the fund on Dec. 27.

"PNC Funds' primary business strategy is to offer investors differentiated, actively managed mutual funds," and the passively managed **S&P 500 Index** Fund didn't align with its focus going forward, a spokesman for the firm said.

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THE WALL STREET JOURNAL.
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Investing in Funds & ETFs: A Monthly Analysis --- Saving for Retirement: Target-Date Funds Adjust For a Stock Pullback --- Managers are diversifying their holdings to protect against a downturn, even as some add more stocks

By Michael A. Pollock
1,028 words
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English

Many target-date funds face a challenge in this long **bull market** for stocks: Their high exposure to equities could result in a sharp drop in their value during a major **stock-market** pullback.

To damp the possible impact of such a downturn, managers of many of these funds are diversifying into new types of investments -- even as some also boost their stock exposure in hopes of getting better long-term returns and keeping up with competitors.

For example, BlackRock Inc., among the largest providers of target-date funds, with assets of more than $200 billion in them globally, recently recast one of its three fund series with higher equity exposure and investments in smart-beta exchange-traded funds -- index-tracking funds that are designed to both boost returns and lower risk by using factors other than the traditional market capitalization to create their portfolio. John Hancock is diversifying its target-date funds' holdings with a modest allocation to alternatives to stocks and bonds, such as currency derivatives. And investors in TIAA's target-date funds now own a portion of actual buildings -- not just shares in real-estate investment trusts -- such as a 24-story luxury condo structure near New York City's Madison Square Park.

Because some of these strategies are relatively new, it's uncertain how well they will bolster fund performance in another market downdraft, says Jeff Holt, who helps oversee manager research at fund tracker Morningstar. In 2008-09, the most equity-heavy target-date funds shed more than 30% of their value before eventually recovering.

Today, more working people than ever own target-date funds through employer-sponsored 401(k) plans or other tax-deferred accounts. These funds start with very high equity exposure when their investors are presumed to be relatively young and slowly shift toward more-conservative investments as they get closer to retirement -- known as the equity glide path. U.S. target-date assets are approaching $1 trillion.

With life expectancies increasing and future returns in many asset areas projected to be lower than they have been in recent years, investors need more equity risk to save enough for retirement, says Fredrik Axsater, a senior executive at Wells Fargo Asset Management. Last year, the firm overhauled its flagship target-date funds, lifting the stock allocation modestly for investors approaching retirement and adding smart-beta ETFs that focus on factors such as valuations, price momentum, **volatility** and measures of financial health to determine the weightings of their investments.

Because many smart-beta ETFs focus on a relatively narrow slice of the **stock market**, they can make it easier for managers of target funds to tweak strategy in response to shifting market conditions by buying or selling them. And because the ETFs' fees are low, Wells Fargo has been able to trim expense ratios on its target funds to 0.19% of assets annually from 0.30%-0.37%.

BlackRock made some similar changes. The equity glide path for its LifePath funds, which had started to decline almost immediately from initial stockholdings in the high 90% area, now hovers around 99% for more than the first decade of an investor's participation. That doesn't materially boost risk and significantly improves returns, says Matthew O'Hara, global head of investments for LifePath funds.

BlackRock also revamped one of its three target-date series to put up to 90% of portfolios into smart-beta ETFs such as iShares Edge MSCI Min Vol EAFE (EFAV) and iShares Edge MSCI Min Vol USA (USMV). That enabled it to lower expense ratios to 0.21% to 0.22%, about half that of its actively managed target-date series.

Northern Trust Asset Management in 2016 lifted the peak equity exposure of target funds by 5 percentage points to 85%. But unlike most peers, its funds start in the low 80% area and don't hit peak stock allocation until a hypothetical investor is 45, about when stock exposure starts declining again. That's to trim **volatility** early on, when people with smaller balances may be more inclined to cash out, says Sabrina Bailey, global head of retirement solutions. The firm further diversifies by putting some assets in markets that don't closely track stocks, such as commodities and global real estate.

While it hasn't changed its equity glide path, Principal Financial Group, based in Des Moines, Iowa, recently made portfolio shifts intended to boost returns and damp **volatility**. Its target-date portfolios, which invest in other individual mutual funds, modestly increased holdings in non-U.S. stock funds. Some also added a fund that focuses on less **volatile**, dividend-paying stocks, a move that managers hope will "minimize a little of the downside" during any market corrections, says portfolio manager Randy Welch.

John Hancock's Multimanager Lifetime funds, which also use a fund-of-funds approach, try to steady the ride by shifting to more defensive stocks as the target retirement date grows near. The funds also have a modest allocation to alternatives, including funds that wager on gyrations in the global currency market. Portfolio manager Nathan Thooft says the allocation to alternatives totals around 4% to 5%.

TIAA has taken an unorthodox step in its Lifecycle offerings: putting some fund money into the ownership of buildings. It began doing that in mid-2016 and eventually expects such holdings to represent about 5% of portfolios.

Although its target-date offerings already had real-estate exposure through holdings of real-estate investment trusts, TIAA tapped into a $100 billion global real-estate fund managed by one of its affiliates to invest directly in properties, says John Cunniff, who oversees two target-date series. "Having a diversifying asset like real estate could be a great benefit during a full market cycle" for stocks.

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REVIEW & OUTLOOK (Editorial)
The Selloff Arrives, Finally

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Believe it or not, sometimes stocks go down. That eternal reality hit hard this week with the fall of the **Dow Jones Industrial Average**, which dropped more than 650 points on Friday.

Friday's jobs report was steady as she goes for the recovery -- nonfarm payrolls increased 200,000 in January, and unemployment remained unchanged at 4.1%. But one measure that deserves particular notice is wage growth: Average hourly earnings increased 2.9% year-over-year. This is the fastest pace since 2009. An unfortunate artifact of the recovery during the Obama Presidency's eight years was stagnant incomes. This wage revival is a welcome sign that the benefits of a tight labor market are starting to flow to workers in higher incomes.

Nonetheless, Friday's market endured a bond-market selloff, with the yield on **10**-**year Treasury** notes topping 2.852%. Markets interpreted the growth in wages as a signal of higher inflation, which would cause bond investors to demand higher rates in advance of an interest-rate increase by the Federal Reserve.

But increasing the return on labor does not guarantee inflation. The Fed has signaled for months that it eventually will increase rates. A bond selloff doesn't necessarily mean a Fed move toward more rapidly raising rates is imminent. New Fed Chair Jerome Powell is widely expected to pursue the policy of measured rate increases initiated by his predecessor Janet Yellen. In any event, we've lived with a long period of historically low rates and a return to higher interest rates is inevitable, and an economy growing faster should be able to bear it.

Stock corrections are inevitable along the way, and to the extent the past week's downward move recognized this reality, it should be welcome. After healthy gains for months, some profit-taking was going to happen.

We hope this reality sinks in at the White House, where President Trump has been overselling the **stock market**'s gains as central to his economic record. He'd be better off sticking with the advances occurring on his watch in the real economy. Let the **stock market** fend for itself.

(See related letter: "Letters to the Editor: Credit Where Credit Is Due" -- WSJ Feb. 8, 2018)

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Heard on the Street
Wage Growth Starts to Ramp Up

By Justin Lahart
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[Financial Analysis and Commentary]

If wages have finally started a sustained rise, imagine what will happen to the economy when businesses and consumers start spending their tax-cut windfalls. And imagine how the Federal Reserve will respond.

Investors were worrying about just that after Friday's jobs report, sending the **Dow Jones Industrial Average** 666 points lower.

The Labor Department reported that the economy added 200,000 jobs in January and that the unemployment rate stayed steady at a low 4.1%. But the big news was wages. Average hourly earnings rose 0.3% from a month earlier, and the December figures were revised higher. That put them 2.9% above the year-earlier level, marking the strongest gains since mid-2009.

The wage figures provided some of the strongest evidence yet that the job market has tightened. With the potential for inflation picking up, the Fed probably won't have any qualms over raising rates three times this year and might start leaning toward four.

Bond investors pushed the yield on the **10**-**year Treasury** note to its highest level since 2014. And stock investors are worried, too, because one of the reasons shares are so expensive is that they look relatively cheap compared with low-yielding Treasurys.

Today's wage numbers understate the boost to spending power that many consumers have gotten or are just seeing. One-time bonuses, like the ones that companies announced late last year, don't get included in average hourly earnings. And many of the companies that said they would raise wages hadn't done so by mid-January when Labor was collecting data.

The tax cut will help boost wages in two ways. Starting this week, workers begin to see lower withholding in their paychecks, meaning more cash in their bank accounts. At least some of that is going to be spent, boosting demand and prompting companies to hire more workers to keep up. The second impact will be businesses, which got the biggest chunk of the tax cut, using some of the windfall to pay higher wages to get the workers needed to meet the higher demand.

All this is happening in a tight job market in which wage growth is finally starting to kick in. Before the year is over, the Fed may decide that even four rate increases aren't nearly enough.

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Bitcoin Selloff Picks Up The Pace

By Steven Russolillo and Kenan Machado
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B1
English

Bitcoin plunged below $8,000 in intraday trading, extending its sharp rout since the start of the year in a selloff triggered by a widening regulatory crackdown on cryptocurrencies.

Late Friday in New York, bitcoin had recovered to $8,524, down 6.8% on the day after slipping below $7,700. That was the lowest level since November.

At its low point, the digital currency had fallen about 60% from an intraday record of $19,783 in December, according to research site CoinDesk Inc. That marks bitcoin's third biggest drop over the past five years. It fell 76% in the spring of 2013 and 85% from November 2013 to January 2015.

Bitcoin's sharp swings illustrate just how much the digital currency remains a highly illiquid and **volatile** investment, particularly relative to stock, bond or currency markets.

In its nine-year history, it has had five peak-to-trough declines of more than 70% apiece, said Charlie Bilello, director of research at New York advisory firm Pension Partners. It fell 94% in less than a month in 2010 -- and again over a five-month stretch in 2011 -- but both times bounced back.

The recent decline in some regards feels more severe, as the magnitude of the price drop offers a dose of reality to new investors who poured money into cryptocurrencies during last year's rally. Many were drawn to the prospect of investing in currencies outside the control of central banks and governments, but now are having to succumb to market forces.

"Headlines for crypto have been mostly negative lately," Thomas Lee, managing partner at New York-based Fundstrat Global Advisors, wrote in a note to clients. "It has been a terrible few weeks, but the fundamental positive story for crypto remains intact," Mr. Lee added, referring to strong millennial interest in cryptocurrencies.

Robinhood, an online trading app that targets young people, this past week said more than one million people joined its wait list to trade cryptocurrencies after it announced plans to offer crypto trading services.

Meanwhile, some big banks are putting up roadblocks to buying bitcoin. JPMorgan Chase & Co., Citigroup Inc. and Bank of America Corp. said Friday that they no longer would allow credit-card holders to use the cards to buy bitcoin.

Regulatory scrutiny is behind much of the reason for bitcoin's sudden fall. India is the latest country to crack down on the cryptocurrency market, following in the footsteps of China and South Korea. That pressure shows that governments are turning out to be much harder to circumvent than cryptocurrency advocates once thought.

Bitcoin fell 28% in January, its steepest monthly decline in three years.

In the bitcoin futures market, in which traders can bet on the ups or downs in the digital currency, hedge funds have shifted their positioning so **bearish** bets outnumber **bullish** ones by more than 3 to 1, according to data released Friday by the Commodity Futures Trading Commission. A week earlier, hedge funds had been biased toward the **bullish** side, the CFTC data show.

The current mood is a far cry from the end of last year, when cryptocurrency investment mania hit feverish levels. A popular bitcoin-services company called Coinbase briefly drew some 100,000 new customers a day around Thanksgiving, as bitcoin approached $10,000, up from under $1,000 at the start of 2017.

Prices more than doubled from there, peaking at $19,783.21 on Dec. 17. Then came a six-week slide.

Alex Beene, a 30-year-old from Nashville, Tenn., cashed out as the decline accelerated. He said he recently sold all his bitcoin, locking in a profit of over $60,000.

Mr. Beene, who writes children's books and works in the Tennessee Department of Labor and Workforce Development, said he bought most of his bitcoin in September, before prices surged over 500% in the following months.

"You'd wake up to $5,000 to $10,000 gains on consecutive mornings," he said. "It was like a money train that wouldn't end, but you could tell [it] wasn't going to last."

It didn't.

Mr. Beene did keep some litecoin -- an alternative digital currency -- in his portfolio. The price of litecoin is down more than 60% from a high in December, according to research site CoinMarketCap.

He called the weekslong selloff "a scary scenario."

Indian Finance Minister Arun Jaitley said Thursday that the government doesn't recognize digital money as legal tender and would "take all measures to eliminate use of these crypto-assets in financing illegitimate activities or as part of the payment system."

Vaibhav Parikh, partner at Indian law firm Nishith Desai Associates, said some people might have misinterpreted, wrongly concluding the government was banning bitcoin.

"The Indian government said it will only crack down on the use of bitcoin for illegal activities and not on the currency itself," he said.

Other governments, particularly in Asia, have taken stringent approaches to cryptocurrency.

South Korea is implementing new legislation aimed at cooling its red-hot bitcoin market. China has gone even further, ordering cryptocurrency exchanges to close and moving toward limiting bitcoin mining operations, in which new bitcoin are minted.

In Japan, $530 million of a cryptocurrency called NEM was swiped in a heist on the exchange Coincheck Inc.

In the U.S., regulators have warned of fraud in initial coin offerings, a new form of fundraising by which a company creates a new virtual coin or token and offers it for public sale. The offerings have attracted billions of dollars.

Even Facebook Inc. is cracking down. The social-media company said this past week that it would stop running ads promoting cryptocurrencies and initial coin offerings.

"I don't think this is the end of the line for cryptos, but I'm certainly not touching any until more stability can be reached," Mr. Beene said.

AnnaMaria Andriotis and Alexander Osipovich contributed to this article.

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Wage Growth Feeds Market Unease --- Pay rises add to evidence economy is heating up

By Ben Leubsdorf
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A1
English

A tightening labor market delivered the biggest annual increase in wages since the end of the recession, a new signal that U.S. workers are beginning to enjoy the pay raises long missing in a steady but tepid expansion.

The Labor Department reported Friday that average hourly earnings for private-sector workers rose 2.9% in January from a year earlier, their largest year-over-year increase since June 2009, when the last recession ended.

Businesses had been reporting for months that the pool of available workers was becoming tight across a range of industries as unemployment fell, forcing them to push up pay. But it hadn't shown up clearly in economic data.

The latest evidence of a pay pickup came in the government's closely watched monthly jobs report, which also showed that nonfarm payrolls rose a seasonally adjusted 200,000 in January, more than economists had expected. The unemployment rate held at 4.1%, its lowest level since December 2000, for the fourth straight month.

January was the 88th consecutive month of job creation, the longest streak of continuous hiring on record and a testament to the durability of the economic expansion that began in mid-2009, even though the pace of overall economic growth has lagged behind historical levels.

"You're slowly getting back to a more normally functioning economy," said Steven Blitz, chief U.S. economist at TS Lombard.

Investors took the report as fresh evidence that the economy is heating up and lifting long-dormant inflation. Yields on **10**-**year Treasury** notes, which tend to rise on signs of inflation, jumped to 2.852% on Friday. They had been near 2% in September.

The **stock market**, reacting in part to fears of rising interest rates rather than hopes of a stronger economy, fell sharply. The **Dow Jones Industrial Average** declined 665.75 points, or 2.54%, to 25520.96.

Monthly wage data can be **volatile**. A wage pickup in 2015 and 2016 stalled last year. Moreover, there were some blemishes in the latest wage numbers. The average workweek declined in January, meaning the average weekly paycheck declined from December even though hourly wages rose. Managers seemed to enjoy the biggest raises; wages for production workers and nonsupervisors, who account for 82% of the private-sector workforce, rose a more modest 2.4% from a year earlier.

Still, the latest pickup in wages seemed to confirm what executives in boardrooms have been saying for months about the challenges of keeping workers when labor was becoming more scarce. A separate Labor Department report earlier in the week showed private-sector wages and salaries were up 2.8% in the fourth quarter from a year earlier, matching the strongest year-over-year gain since 2008.

Jason Patrick, who owns the Nashville, Tenn., office of staffing firm Express Employment Professionals with his wife, said the tightening labor market means more workers are jumping to new jobs compared with recent years.

Pay for workers placed by the firm has gone up 11% during the last year, he said, as companies try to retain employees. Also, "they are having to provide more training, more development for their people, better engagement with their employees," Mr. Patrick said. "They're really having to work to keep their talent."

Some Federal Reserve officials have said the U.S. has reached full employment, a stage in the business cycle when almost everyone who wants a job can find one. In theory, if the jobless rate falls much more at a moment of full employment, the economy would overheat, creating sustained inflation above the Fed's 2% target, or unhealthy booms in **financial markets**. The Fed tends to respond to such overheating by raising interest rates to cool the economy.

Investors and analysts expect the central bank will raise short-term interest rates at its next policy meeting in March. Fed officials in December had penciled in three quarter-percentage-point rate increases in 2018, but some officials may push for a faster pace.

"We've been waiting for wage growth," and Friday's report contained "one of the first signs that we're seeing wage growth finally start to pick up," Federal Reserve Bank of Minneapolis President Neel Kashkari said Friday on CNBC. "I do think, if wage growth continues, that that could have an effect on the path of interest rates."

The U.S. economy entered 2018 with healthy momentum after posting its best year of growth last year since 2014. Many forecasters expect growth will be supported this year by solid consumer and business confidence, stronger conditions overseas and tax cuts at home that could boost investment and spending.

A tighter labor market is a boon for people looking for jobs. Theresia Carrigan, a 29-year-old licensed social worker in Maryland, was let go from her job at a crisis-housing shelter in January. She said she braced herself for an extended period of unemployment, but found employers were eager to snatch up qualified workers.

"Places are calling back within, not days, hours," she said. "I was getting interest within less than a day, places calling me back for interviews."

Ms. Carrigan said she was hired within a week by an eldercare agency.

(See related article: "Dow drops 4.1% in week, bond yields climb" -- WSJ Feb. 3, 2018)

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The New York Times

National Desk; SECTA
Stocks Plunge As Boom Starts To Look Shaky

By MATT PHILLIPS
1,158 words
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Investors have spent much of the last year shrugging off geopolitical and economic risks, from the threat of nuclear conflict with North Korea to a potential trade war with China. Instead, they have focused on the strength of the United States economy, driven by banner corporate profits and President Trump's push to lower taxes and reduce regulation.

The optimism helped lift stock markets ever higher, extending the boom into its ninth year.

Now, investors are suddenly skittish.

On Friday, stocks tumbled by more than 2 percent, propelling the market to its worst week in two years.

The immediate catalyst was the jobs report, which showed the strong United States economy might finally be translating into rising wages for American workers -- a sign that higher inflation could be around the corner. But what is really worrying investors is that the fuel behind this **stock market** boom, namely cheap money from global central banks, may disappear sooner than they thought.

In recent weeks, the shift in sentiment has played out across the world's largest **financial markets**. As stocks have sold off, Treasury yields have surged. The dollar has slumped.

''It's a legitimate concern, when inflation spikes up a little bit, that people should evaluate how is this going to affect profits and how is this going to affect the Fed,'' said Jonathan Golub, chief United States equity strategist at Credit Suisse. ''The market is becoming more vigilant around these concerns, and that's good and that's healthy.''

In a strange way, investors are nervous that the global economy is doing too well.

Since stocks began climbing during the depths of the Great Recession in 2009, their rise has been supported by some of the lowest global interest rates seen since World War II. To jump-start growth, central bankers around the world slashed interest rates and took other steps to push down yields on safe government bonds.

Their goal was to incentivize investors to put their cash to work in the economy -- for example, by buying corporate stocks and bonds -- rather than stashing it in the relative safety of government bonds. The theory is that the fresh flood of capital would make it easier for companies to raise money, invest in their businesses and hire workers. Central banks wanted to heal their economies.

They have healed.

For the first time since the financial crisis of 2008, the world's largest economies are growing in unison. The United States and China led the way, but the expansion now includes Europe, long mired in a debt crisis, and perennially laggard Japan.

Given the strength of the global economy, central banks, led by the United States Federal Reserve, have started to remove some of the supports that helped supercharge stock and **bond prices** over the last decade. The Fed started raising rates two years ago. And with the robust jobs report on Friday showing the fastest wage growth in years, some think the pace of rate increases could quicken.

Average hourly earnings for United States workers were 2.9 percent higher in January than the previous year, the fastest annual increase in years. Although a welcome development for workers, economists often view rising wages as an early indication of inflationary pressure. If faster price increases do begin to emerge, the Fed could try to head them off with more aggressive rate action.

Janet L. Yellen, the Federal Reserve's departing chairwoman who had her last working day on Friday, was viewed by some as being more concerned about measures of weakness in the job market than by the risk of rising inflation, and therefore more willing to keep rates low. Her successor, Jerome H. Powell, will face different challenges as the Fed charts a new course in raising interest rates.

Interest rates that are set every day in the global bond markets are already leaping higher, in anticipation of central bank rate increases later this year. On Friday, the yield on the **10-year Treasury** note -- a widely used gauge for overall interest rates -- rose to more than 2.8 percent, the highest level since early 2014.

Rising rates have myriad consequences, including making it more expensive for companies and individuals to borrow money, like for buying a home or a car. The average 30-year fixed mortgage rate is around 4.2 percent, up from less than 4 percent at the end of 2017.

Uncertainty about how the economy will react to rising borrowing costs has raised the blood pressure of investors. In one sign of a shift underway, a measure of expected market turbulence, the CBOE**Volatility** Index, jumped by more than 25 percent on Friday. The so-called VIX has spent months at historically low levels, reflecting a placid market mood that seems to have evaporated over the last week.

The stock markets this week have reflected the jitters.

The energy sector was especially hard hit, with energy giants ExxonMobil dropping 5.1 percent and Chevron falling 5.6 percent on Friday after reporting lackluster earnings. The energy sector of the **Standard & Poor's 500-stockindex** fell 6.4 percent during the week, the biggest drop of all industrial sectors in the benchmark.

Health care stocks did not fare much better. Express Scripts, Cigna and UnitedHealth Group, among others, were battered Tuesday after Amazon, JPMorgan Chase and Berkshire Hathaway announced they were teaming up to create a health care company for their employees.

Tech stocks, which have been a crucial driver of the broader market rise, also slipped. Apple reported record-breaking profit late Thursday, but the company disappointed investors with a weaker-than-expected sales forecast. Its shares sank roughly 4.3 percent on Friday, worse than the broader market.

That is not to say the market is collapsing. The **S.&P. 500** fell 3.9 percent this week. Still, it remains close to historic highs and 21 percent above where it stood a year ago, after another year of solid economic growth.

The United States economy expanded by a 2.6 percent annual rate in the fourth quarter of 2017. That is below the pace of some past expansions -- the economy grew at around 4 percent annually in the late 1990s. But it is enough to keep creating significant numbers of jobs, including 200,000 in January.

The economic expansion should be a comfort to investors. Higher revenue allows companies to offset rising costs, such as workers' pay, if inflation picks up. The tax cuts are also expected to help bolster growth.

''If we start to see growth slowing and inflation acceleration, that's when I get concerned,'' said Erin Browne, head of asset allocation at UBS Asset Management. ''As long as growth continues to improve, a little bit more inflation that we're seeing now is fine.''

CHART: **Standard & Poor's 500-stockindex** (Source: Thomson Reuters) (A11)

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REVIEW & OUTLOOK (Editorial)
Drilled, Baby, Drilled

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Readers of pre-millennial vintage may recall the 2008 presidential campaign when Republicans and especially Sarah Palin picked up the chant "drill, baby, drill" as a response to soaring **oil prices**. The theme was much derided, not least by Barack Obama, who as late as 2012 called it "a slogan, a gimmick, and a bumper sticker" but "not a strategy." Ten years later, who was right?

The U.S. Energy Information Administration (EIA) reported Thursday that U.S. crude oil production exceeded 10 million barrels a day for the first time since 1970. That's double the five million barrels produced in 2008, thanks to the boom in, well, drilling, baby.

The EIA summary puts it this way: "U.S. crude oil production has increased significantly over the past 10 years, driven mainly by production from tighter rock formations including shale and other fine-grained rock using horizontal drilling and hydraulic fracturing to improve efficiency." This is the "fracking" boom our readers know well that has been driven by innovation in the private oil and gas industry.

The magnitude of the boom is remarkable. The gusher has pushed the U.S. close to overtaking Saudi Arabia and Russia as the world's leading oil producer. In 2006 the U.S. imported 12.9 million barrels a day of crude and petroleum products. By last October that was down to 2.5 million a day. Some gimmick.

This translates into greater energy security as the U.S. is less dependent on foreign oil sources. Donald Trump calls it "energy dominance," which implies that the U.S. wants to husband its supplies like gold at Fort Knox. The reality is we want to produce and sell what the market will bear, including exports to willing buyers around the world.

Thanks to Congress's deal with Mr. Obama in 2015 when Republicans extended wind and solar subsidies in return for lifting the oil export ban, the U.S. exported some 1.5 million barrels of oil a day in November. Some readers may recall that Heritage Action instructed Congress to vote no, and Breitbart called the bill "a total and complete sell-out of the American people." Perhaps even they can now see that trading temporary subsidies for a permanent change in export law was shrewd and good for the country.

Also striking is how quickly the oil and gas industry has recovered from the **oil price** plunge of 2015-2016. Previous price declines led to multiple bankruptcies and bank failures. This time drillers adapted quickly, took the rig count down fast, and cut costs. America's flexible private capital markets helped the companies ride out the price trough, and now producers, investors and lenders are reaping the benefits of the **oil price** rebound to $69 a barrel.

And don't forget the fracking boom in natural gas. EIA says U.S. gas production increased by some 50% from January 2010 to November 2017, reducing carbon emissions and heating prices. Thanks to new export terminals, the U.S. is now selling liquefied natural gas around the world. This has the potential to compete with Russian gas so Western Europe doesn't have to succumb to Vladimir Putin's periodic energy blackmail. Unleashing U.S. energy is Donald Trump's best Russia containment strategy.

It's worth stressing some of the policy lessons in all this. The first is that the best response to energy shocks is to let the market adjust to the price signals. As **oil prices** soared in the latter half of the last decade, politicians panicked and rushed to ban certain light bulbs, and subsidize and mandate cellulosic ethanol and other energy fads. The media fed the panic and cheered the politicians on. We were back at "peak oil" and the end of fossil fuels.

Yet American ingenuity was already discovering the solution for high prices in the shale plays of North Dakota, Pennsylvania, Texas and elsewhere. These drillers could move fast because they had the support of private capital and could lease private land. The frackers were also largely regulated by the states, which meant even the Obama Administration couldn't stop them.

This is a familiar American story of invention and wealth creation that benefits everyone, but it never would have happened if central planners in Washington had to approve it. That's the most important lesson.

(See related letter: "Letters to the Editor: We Can Drill Our Way Free" -- WSJ Feb. 23, 2018)

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The New York Times

Strategies
Your Money
The Stock Market Works by Day, but It Loves the Night

By JEFF SOMMER
1,330 words
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NYTimes.com Feed
NYTFEED
English

The daytime is for losers. Overnight is when the big money is made in the **stock market** — not by trading but by getting a good night's sleep.

That's because of a gap between daytime and overnight returns in the American **stock market**. The real profits for investors have come when the market is closed for regular trading, according to a new **stock market** analysis by Bespoke Investment Group.

The Bespoke data builds on the findings of academic researchers, who have documented the existence of the gap, without being able to entirely explain its cause.

"We can show that the gap exists," said Huseyin Gulen, a finance professor at Purdue University who has written about the issue. "But at this point we don't know exactly why."

Simply put, the gap may be defined as the difference between stock returns during the hours the market is open, and the returns after regular daytime trading ends. How the gap is calculated may not be intuitively obvious, though.

One set of returns is straightforward: It is based on prices at the start of trading in New York at 9:30 a.m. to the market close at 4 p.m. The second set is, essentially, the reverse: It is price returns from the 4 p.m. close to the market opening at 9:30 a.m. the following day.

Because stock prices at the market open tend to be higher than the price at the previous day's close, you don't actually have to stay up all night and trade on an electronic network to rack up overnight gains. Simply holding shares while you sleep will do it. So for buy-and-hold investors, these findings are particularly encouraging: Get your rest, ignore the temptation to trade and you can do just fine.

The new Bespoke analysis focuses on the returns of the first exchange-traded fund in the United States: the SPY or SPDR **S&P 500** E.T.F., which started trading on Jan. 29, 1993. That E.T.F. mirrors the **Standard & Poor's 500-stockindex**, which often serves as a proxy for the entire **stock market** (though it actually represents only 500 of the biggest companies).

The SPY's overall price gain from its inception through January has been stupendous: 541 percent cumulatively, not counting dividends, Bespoke says.

But look more closely, as Bespoke did, and a remarkable fact emerges.

Separate the daytime and the after-hour returns and calculate them cumulatively, as Bespoke has done, and it turns out that all of that price gain since 1993 has come outside regular trading hours.

If you had bought the SPY at the last second of trading on each business day since 1993 and sold at the market open the next day — capturing all of the net after-hour gains — your cumulative price gain would be 571 percent.

On the other hand, if you had done the reverse, buying the E.T.F. at the first second of regular trading every morning at 9:30 a.m. and selling at the 4 p.m. close, you would be down 4.4 percent since 1993.

For 25 years, in other words, the daytime has been a net loss. To paraphrase Ray Charles, the nighttime has been the right time to be invested in the **stock market**.

One implication is immediate. “Forget about the news and the market ups and downs during the day,” said Paul Hickey, co-founder of Bespoke. “They are nowhere close to what they are cracked up to be.” In fact, he said, most people are better off if they just sit tight.

Buying and holding the overall market — using an E.T.F. like the SPY, or a traditional index mutual fund, or a very diversified portfolio of stocks — has been an extremely profitable strategy if you stuck to it for the last 25 years. On the other hand, buying and selling during the day has generally been a money-losing strategy — one that would have been far more painful if you had traded frequently, incurring steep costs, which would have compounded your losses.

That said, there are plenty of exceptions to these general statements.

Many individuals and institutions have made tons of money through short-term trading during regular trading hours, even if investors over all have not. Furthermore, the steadily rising **stock market** in the 12 months through January has been better in the daytime than it has been historically — posting gains in the SPY during regular trading hours of 9.2 percent. Still, the overnight gains have been much better: 13.4 percent over the same period. The gap in returns has endured.

Why it has done so is the subject of speculation. “We’ve got hypotheses,” said Michael Kelly, a finance professor at Lafayette College, who has studied the issue. “But we don’t really know why it happens.”

One possibility, he said, is that frequent traders laboring under the “illusion of control” believe that they can respond easily to information and events during the day but can’t do so as easily after hours, when there are far fewer market participants and less money, or “liquidity,” involved in trading. “People may be inclined to sell at the market close so they can feel in control of their money overnight,” he said.

There is some evidence that smaller traders are prey to this tendency and tend to sell late in the day — and that some big institutional traders, who are well aware of the day-night gap, tend instead to buy at the close and sell at the open.

Because relatively few people actually trade after the market closes, orders tend to build up overnight, and in a rising market, that will produce an upward price surge when the market opens. But during extended declines, overnight sell orders may cause prices to plummet when the market opens.

If there were no trading costs — possible in a thought experiment but not in the real world — an excellent strategy over the last few decades would have been buying shares at the last possible moment during regular trading hours and selling them methodically at the opening bell every day, Professor Gulen of Purdue said.

While transaction costs make that strategy uneconomical, he said, the concept may still have a certain value. “If you do know that you are going to make a trade on a given day, and you have the ability to choose when you do it, you might be able to take advantage of this pattern — buying late in the day and selling early.” Of course, the pattern doesn’t hold every single day, and you could easily be disappointed.

Part of the gap in returns can probably be explained by the human tendency to panic at bad news, Professor Kelly said. “That panic seems to happen during the day,” he said. “One advantage of not trading during the day is that you aren’t as likely to participate in panicky selling.”

His data shows that during the **bear market** year of 2008, the overall market, as represented by the SPY E.T.F., declined 36.8 percent. But most of the damage occurred during the day, with losses of 26.7 percent, compared with only 13.8 percent overnight.

But further study needs to be done before the mystery of the day-night gap is unraveled, he said.

In the meantime, Mr. Hickey said, “If you are tempted to day trade, this is another argument for not doing it,” he said. “And trading after hours is in some ways, even riskier, because with fewer people in the market, prices can be erratic.”

Slow and steady investing generally avoids these problems. And over long periods, it has paid off. Frequent trading generally has not, either night or day.

Minh Uong/The New York Times

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Tax Law Spurred a Rush To Charitable-Giving Funds

By Richard Rubin
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Americans late last year poured money into charitable-giving vehicles known as donor-advised funds, which allow immediate tax deductions but gradual distributions to nonprofits -- a sign of ways the new tax law could reshape how Americans donate money for years to come.

The aim was to make donations before the new year, when, for tax purposes, giving became less advantageous for many households. People turned to donor-advised funds run by local nonprofits or those affiliated with big money-management firms. These funds allowed taxpayers to lock in deductions for 2017, then designate when and where to disburse the money.

Fidelity Charitable, the largest donor-advised fund, added 22,000 accounts last year, nearly double its goal, pushing its total to 105,000, said Pam Norley, its president. Donors created 3,200 new accounts at Vanguard Charitable in 2017, about double the 2016 total, while total contributions were up 16% for the year to $1.6 billion. More than 20% of Schwab Charitable's 45,000 accounts were started in the second half of 2017.

The boomlet extended to smaller community nonprofits that support local initiatives and also house donor-advised funds. Such funds at the Cleveland Foundation, for example, received $26.5 million in December, more than the previous three Decembers combined.

"It was a crazy month," said Kaye Ridolfi, the Ohio foundation's senior vice president of advancement. "The phone was ringing off the hook."

The new tax law's treatment of deductions gives people more reasons to concentrate giving in certain years, both inside and outside donor-advised funds. But widespread bunching of contributions could make it difficult for charities to plan from year to year.

"When you get people in the habit of saving for charity instead of giving to charity, there is a tendency for funds to be set aside, because that's what we do in savings accounts," said Ray Madoff, a Boston College law professor who specializes in taxes and philanthropy.

A donor-advised fund is an investment account held for charitable purposes. Donors take tax deductions when they put money in, then recommend grants to charities over time.

Donor-advised funds held $85 billion in total assets in 2016, according to the National Philanthropic Trust. Such funds affiliated with commercial money managers are now among the nation's largest charities.

The funds linked to investment firms such as Fidelity and Vanguard typically charge administrative fees to the funds to pay for the operations of the nonprofit organizations associated with the investment firms. The funds are often invested in vehicles managed by those firms and generate fees for the for-profit business.

The new tax law made these funds especially attractive. Congress nearly doubled the standard deduction to $24,000 for a married couple and limited the state-and-local-tax deduction to $10,000. As a result, more people will claim the standard deduction and far fewer will claim itemized deductions and get a direct benefit for their charitable contributions.

According to the Tax Policy Center, about 11% of households are projected to itemize deductions, down from 26% under the prior law.

More taxpayers had an incentive to bunch several years' worth of donations in 2017, before the higher standard deduction and lower tax rates took effect. Such bunching could now become a common charitable practice because people would concentrate donations to exceed the standard deduction only in some years.

"You could not have designed a tax bill that would have driven more money into donor-advised funds," said Ms. Madoff, of Boston College, who is critical of the funds.

Dalton Rushing and his wife, Stacey, both Methodist pastors in Decatur, Ga., created a donor-advised fund with their projected $18,700 tithing to their churches for 2018, plus other planned gifts. They set automatic withdrawals from the fund for their tithing.

"We knew what we wanted to give away in 2018 and so we started thinking, is there a creative way for us to do this?" Mr. Rushing said.

In California, accountant Dennis Young realized his own tax situation would change. He has no mortgage, so he doesn't take that interest deduction, and the $10,000 state-and-local tax deduction and his typical $10,000 charitable donations wouldn't exceed the new standard deduction.

Mr. Young, a partner of Young, Craig & Co. in Mountain View, Calif., said he added $30,000 to a donor-advised fund run by the Los Altos Community Foundation. His plan: alternate years between taking the standard deduction and donating to his fund and claiming itemized deductions.

The **stock market**'s rise in 2017 amplified the rush to create donor-advised funds. Donors who give appreciated assets get an added benefit: They avoid paying capital-gains taxes when they make the donation, and they get a deduction against their income taxes for the full value of the asset.

"The tax reality plus the markets being strong made it a bit of a no-brainer," said Kim Laughton, president of Schwab Charitable, which holds about $13 billion of assets in its donor-advised funds. "Anyone who has one of these accounts realizes how useful it can be."

The National Philanthropic Trust, which holds about $6 billion in donor-advised funds, had its biggest December ever, with $1.2 billion in contributions, up 20% from 2016.

In November, donors weren't convinced that Congress would actually finish the tax bill, said Eileen Heisman, the group's president and chief executive officer. The House took the final vote Dec. 20.

"We had a huge spike in gifts in the last eight working days of the year. Just huge," Ms. Heisman said.

The Community Foundations of the Hudson Valley in New York sent an email to donors about the tax law. One donor printed it out and sent it back with a $10,000 check, said March Gallagher, the group's president and chief executive. December donations in newly created funds to the foundation went from about $122,000 in 2016 to $1.2 million in 2017.

"That was a really effective email," Ms. Gallagher said.

Most people in the top 5% of households will still itemize and therefore can still get the full charitable deduction. Many in the upper middle class now have a smaller incentive to give money away because they will be taking the standard deduction. Many of them would also have an incentive to concentrate donations only in some years.

Fund sponsors say most donors make regular distributions and say those payments to charities have been increasing, too. Vanguard Charitable has created an online tool to help donors find charities that fit their priorities. In 2017, Vanguard's funds distributed $874 million, up 28% from 2016. Fidelity has seen increasing use of a mobile application that lets donors distribute in increments as small as $50.

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Streetwise: This Trust Makes Bet On Next 100 Years

By James Mackintosh
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English

Everything is expensive in the markets these days, but some things are more expensive than others. Shares are, historically, very highly valued, but not nearly as pricey as bonds, especially very long-dated bonds. The result is a lot of reluctant buyers of stocks -- and one investor willing to put on what is literally the trade of the century. The next century.

The trade goes like this: Borrow GBP 750 million ($1 billion) for 100 years at a time when money is basically free. Invest it in shares. Pocket the difference.

There are a few teensy tricks along the way, but essentially this is what Wellcome Trust, a London-based biomedical research charity that spends more than any other besides the Gates Foundation, has just done.

Wellcome Chief Investment Officer Nick Moakes says ultralong bonds are distorted by rules forcing insurance companies and pension funds to buy them at any price, creating an uneconomic demand he is happy to satisfy with a bond issue. The scale of that demand was shown Wednesday when Wellcome's 100-year bond was more than four times oversubscribed with a coupon of just 2.517%, the lowest ever paid on a corporate century bond.

Wellcome isn't the first to this idea. The endowment of Clare College, part of Cambridge University, decided to borrow for 40 years and invest the proceeds in the **stock market** in 2008.

Few investors have the history to be able to borrow for 100 years, let alone the confidence to borrow to buy stocks. But on a small scale many of us are doing something similar, by having both a mortgage and an investment portfolio. The difference in Wellcome's case is the explicit decision to borrow to invest, but the outcome is the same: lots of shares and lots of debt.

It isn't enough to make money on shares, of course. Borrowing to invest means making money even after the cost of borrowing, which in effect is a bet that shares will beat bonds. Again, that has been true in the long run almost everywhere, but there can be long periods when it doesn't work out.

Most recently, the **S&P 500** lagged behind a 10-year U.S. Treasury note, rolled over into the latest issue each month and reinvesting income, from 2000 until November last year. Investors who bought British stocks just before the 1987 crash are still very slightly behind an equivalent investment in 10-year gilts, with a lot more heartache along the way.

Still, we have been living through a golden age for bonds since the 1980s, with prices soaring and yields collapsing to multicentury lows. It is hard to see how that can be repeated, and many stock markets look attractive in comparison.

The question is just how attractive, given the uncertainties around stocks. Mr. Moakes assumes global stocks and real estate return 4% above inflation, which, assuming no fall into deflation, will be far above the 2.5% nominal cost of the bonds Wellcome has issued. Compound it over 100 years and the profit if he is right would be more than GBP 20 billion above inflation of 2%.

For those of us with shorter investment horizons, it is harder to apply the logic, because actual returns are often a very long way from the best guess of future returns even over a decade.

Wall Street's favorite way to assess future real returns is the inverse of the forward price/earnings ratio, known as the earnings yield. At 5% for the **S&P 500**, it is well below its longer-run average, and 10-year returns have in the past come in below what was indicated, too. Still, just 2 or 3 percentage points above inflation would be welcome when 10-year U.S. Treasury yields are only just above inflation, and in most of the developed world are well below inflation.

Long-term investors often use Yale Professor Robert Shiller's cyclically adjusted price/earnings ratio, known as CAPE, instead. When valuations are high, future returns on average have been lower, and vice versa, but with a wide spread around the average. Prof. Shiller's calculations for the U.S. suggest bonds are expected to beat stocks over the next decade -- even though when CAPE hit its current level in early 1998, equities went on to beat inflation by 2 percentage points annually for the next 10 years.

A more cautious approach assumes that both valuations and profit margins fall back to long-run averages, which leads Boston fund manager Grantham, Mayo, Van Otterloo & Co. to expect losses from U.S. stocks over the next seven years.

Over 100 years it is reasonable to think that if stocks don't beat bonds, capitalism will have died and charitable foundations be a thing of the past anyway, so Mr. Moakes might as well make the bet. For the rest of us, stocks look like a somewhat better bet than bonds for those who can stomach the **volatility**, but the margin of safety is narrower than it has been since before the great financial crisis.

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De Blasio Unveils $88.67 Billion Budget Proposal --- The city's plan would boost spending by about 4% over this year's adopted budget

By Mara Gay
681 words
2 February 2018
The Wall Street Journal
J
A9A
English

New York City Mayor Bill de Blasio laid out an $88.67 billion budget proposal Thursday, a **bullish** increase in spending amid lingering uncertainty about how sweeping changes to the U.S. tax code could impact the city's economy.

"We're not an island, but we need to think about what will strengthen our economy, and our stability and strength as a city," Mr. de Blasio said during a City Hall news conference.

The plan would boost spending by $2.68 billion over this year's adopted budget, or about a 4% increase. Most of the added spending would go toward the growing labor and pension costs from its large municipal workforce, as well as debt service, according to budget documents released by the city.

City revenues are projected to increase by about the same amount, ensuring the budget will be balanced, city officials said, noting that the revenues were driven by property taxes.

De Blasio administration officials said they were still analyzing the impact of the Republican-led tax plan on city revenues. The mayor has expressed concerns about possible funding cuts under a Republican-controlled Congress. City officials said they could see up to $700 million less in federal funding this year.

The mayor also has criticized state cuts to the city under New York Gov. Andrew Cuomo, a fellow Democrat with whom he publicly has feuded with for years.

The city's cash-strapped public-hospital system, officials said, could lose about $400 million in federal aid unless Congress reinstates funding linked to the Affordable Care Act that it allowed to lapse last year. Officials said they can no longer refinance using tax-exempt bonds under the new tax code, costing the city about $100 million a year. Moreover, they said changes to the tax code had made the Low-Income Housing Tax Credit less appealing to investors, leading to a loss of $200 million in revenues for the city's capital budget.

Mr. de Blasio also said he expected to see about $400 million less in state aid. Morris Peters, a spokesman for Mr. Cuomo, said that assertion is "disingenuous. The City should check its math." He said aid to the city in this year's state budget was "a half billion dollar increase over last year."

Mr. de Blasio saidthe city would work to find another $500 million in savings ahead of presenting the executive budget later this year.

The mayor, who was re-elected in November, has increased spending every year, using strong revenues from a booming economy to roll out his prekindergarten program, build affordable housing and fight homelessness and poverty. Spending has increased by nearly 20% since he took office in 2014, and the city has added more than 25,000 employees.

Under the mayor's proposal, labor costs are projected to rise by about $2.2 billion next year, to slightly more than $49 billion from $46.8 billion in fiscal year 2018, which ends in June. That represents more than 55% of the city's overall budget. The figure is projected to increase to $52.5 billion in fiscal 2022.

The mayor has said the added investment is needed in a growing city. The city's population, currently about 8.5 million, could reach 9 million by 2030, a new projection, Mr. de Blasio said Thursday.

Spending on homelessness would increase under the plan, by about $150 million a year through 2022.

The mayor also has increased the city's reserve fund in recent years, which rose to $1 billion from about $300 million when former Mayor Michael Bloomberg, an independent, left office.

The preliminary budget proposal generally offers a glimpse at the mayor's priorities. In the coming months, the mayor will introduce an executive budget proposal, which must be approved by the City Council by June 30, the end of the city's fiscal year.

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Treasury Will Sell $186 Billion in Debt

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The Treasury Department will auction $186 billion in securities next week, comprising $108 billion in new debt and $78 billion in previously sold debt. Details (all with minimum denominations of $100):

-- Monday: $48 billion in 13-week bills, a reopening of an issue first sold on Nov. 9, 2017, maturing May 10, 2018. Cusip number: 912796PF0.

Also, $42 billion in 26-week bills, dated Feb. 8, 2018, maturing Aug. 9, 2018. Cusip number: 912796PU7.

Noncompetitive tenders for both issues must be received by 11 a.m. EST Monday and competitive tenders by 11:30 a.m.

-- Tuesday: $30 billion in 70-day cash-management bills, a reopening of an issue that was first sold on Oct. 19, 2017, maturing April 19, 2018. Cusip number: 912796PB9.

Also, $26 billion in three-year notes, dated Feb. 15, 2018, maturing Feb. 15, 2021. Cusip number: 9128283X6.

Noncompetitive tenders for the bills must be received by 11 a.m. Tuesday and competitive tenders by 11:30 a.m. For the notes, the deadlines are noon and 1 p.m., respectively.

-- Wednesday: $24 billion in **10**-**year Treasury** notes, dated Feb. 15, 2018, maturing Feb. 15, 2028. Cusip number: 9128283W8. Noncompetitive tenders must be received by noon Wednesday; competitive tenders, 1 p.m.

-- Thursday: $16 billion in 30-year bonds, dated Feb. 15, 2018, maturing Feb. 15, 2048. Cusip number: 912810SA7. Noncompetitive tenders must be received by noon Thursday; competitive tenders, 1 p.m.

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THE WALL STREET JOURNAL.
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IEX Caught Up in Wynn Fallout --- Casino magnate had professed wish to list on upstart exchange as it readies launch

By Alexander Osipovich
450 words
2 February 2018
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B11
English

The sexual-misconduct allegations against Steve Wynn could affect a company that has little to do with casinos: IEX Group Inc., a startup stock exchange that is looking to shake up the business of U.S. corporate listings.

Wynn Resorts Ltd., the casino mogul's company, is the only firm that has publicly expressed an interest in listing on IEX, the heroes of Michael Lewis's 2014 best-seller "Flash Boys."

IEX is in the final stages of preparing to launch a listings business that would compete with the New York Stock Exchange and **Nasdaq** Inc. for corporate issuers.

Mr. Wynn -- the founder, chairman and chief executive of the casino company -- is an investor in IEX and a vocal supporter of its crusade against high-speed trading strategies. He told a business conference in 2014 that he wanted to list Wynn Resorts on IEX, although his representatives have since said he is just considering whether to make the switch.

Wynn Resorts, a member of the **S&P 500**, is listed on **Nasdaq**. IEX had expected the casino operator to be among the initial batch of companies to switch to the new exchange, people familiar with IEX's listings effort said.

IEX declined to comment. The startup hasn't disclosed who the other companies might be or how many it believes there are.

"It's bad timing for them that the person who was going to be their first adopter is now discredited," said Dave Weisberger, head of equities at market-structure consulting firm ViableMkts and a frequent critic of IEX. Wynn Resorts declined to comment.

IEX's listings push already has been beset by delays. The exchange projected in 2017 that it would launch listings this past October, but missed that target after a protracted wait for regulatory approval. It now aims to start listings in coming months.

Having a prominent company like Wynn Resorts in its roster would bolster the credibility of IEX in its bid to win switches from **Nasdaq** and Intercontinental Exchange Inc.'s NYSE. The two incumbent exchanges have an effective duopoly over U.S. corporate listings. NYSE and **Nasdaq** declined to comment.

The Wall Street Journal last week detailed accounts of a pattern of alleged sexual misconduct described by dozens of people who have worked for Mr. Wynn.

Mr. Wynn said it was "preposterous" that he would assault a woman. He didn't provide a further response to other allegations of sexual misconduct that the Journal asked about before publishing the article last week.

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REVIEW & OUTLOOK (Editorial)
Welcome to the Health-Care Jungle

612 words
1 February 2018
The Wall Street Journal
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A14
English

Amazon announced Tuesday that it will join with J.P. Morgan Chase and Berkshire Hathaway to wade into the jungle of U.S. health care, and the news slashed billions in **stock-market** value from health-care companies in mere hours. American health care could benefit from creative destruction, though this would be Amazon's toughest fixer upper to date.

"The ballooning costs of healthcare act as a hungry tapeworm on the American economy," said Berkshire chief Warren Buffett in Tuesday's announcement. The companies will create an entity that "will provide U.S. employees and their families with simplified, high-quality and transparent healthcare at a reasonable cost." One goal appears to be to spread ideas that work.

The announcement offered no details -- nothing on if the companies will set up provider networks or walk-in clinics or what. But an early red flag: The press release says the group will form an "independent company that is free from profit-making incentives and constraints."

The problem with U.S. health care is not an incentive for profit, which has driven innovation and cures for diseases like hepatitis C. The fundamental problem is that the cost of a service is disconnected from underlying value. Patients don't know the price of services and consume health care as if it's free since government or employers are the third-party payers for most Americans.

Government spending, subsidies and regulation complicate the system and increase prices or crowd out private insurance. No doubt the profit comment was a swipe at insurers, and loathing the insurance lobby may be the only bipartisan agreement in health care. But the problem with insurers is not that they want to make money. The problem is rent-seeking -- e.g., insurers supporting a government mandate for everyone to buy their product.

The speculation is that the new outfit will get into pharmaceutical delivery, which makes sense for a company like Amazon whose value proposition includes moving boxes efficiently. Another thought is that the partners will try to cut out pharmacy benefit managers, which negotiate rebates on drugs and placement in formularies. The status quo is offering steep rebates against increasing list prices, which is dysfunctional and also not tied to value or outcomes.

Our advice: Go much bigger. Amazon says they'll focus on technology, and this is an area ripe with possibility, especially if the company is willing to consider some less noticed drivers of health-care costs, including chronic conditions and unnecessary visits.

Amazon could also look at start ups that are trying to deploy new technology. Food and Drug Administration Commissioner Scott Gottlieb has talked about how data from wearable devices could help measure clinical outcomes and inform drug development.

The new creation will represent hundreds of thousands of employees, which sounds like a lot but isn't enough scale to change U.S. health care, and the question is how transformative this enterprise will aim to be. A brick wall of interest groups -- hospitals, insurers, the AMA -- will resist any change and make Uber's fights with taxi cartels look like minor league ball.

But health care is long overdue for a shake up, and the leaders of these companies -- Mr. Buffett, Jeff Bezos and Jamie Dimon -- deserve credit for jumping in. The public would be the beneficiary if this trio can figure out how to lower costs and increase quality, and the odds are better with them than another political intervention.

(See related letters: "Letters to the Editor: Bezos and Partners Offer a Health-Care Reset" -- WSJ Feb. 9, 2018)

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The New York Times

Common Sense
Business Day; Economy
Trump Tax Cuts and the Economy: Time Will Tell, Maybe

By JAMES B. STEWART
1,681 words
1 February 2018
03:09 PM
NYTimes.com Feed
NYTFEED
English

Most presidents will at some point benefit from a surging economy and **stock market**, but none has claimed more credit for them than Donald J. Trump, as he did again during this week's State of the Union address. Among the highlights:

• "$8 trillion and more" in **stock market** gains.

• "2.4 million new jobs" created since his election.

• "Over 3 million workers have gotten tax-cut bonuses" and "rising wages."

• All thanks to "the biggest tax cuts and reforms in American history."

Since the president has frequently complained that the media denies him credit for any of this, I thought it only fair to assess the degree to which the undeniably strong economy, low unemployment and surging **stock market** are because of Mr. Trump's achievements, notably his sweeping tax bill.

It turns out that's no easy task, especially since Mr. Trump has only been president for a year, and the tax legislation is little more than a month old. Economists are still debating the impact on the economy of Ronald Reagan's 1986 tax reform legislation more than 30 years after its passage.

"It's not like chemistry or physics where you can do a controlled experiment and change one variable," said Joel Slemrod, professor of economics and public policy at the University of Michigan, and co-author of a seminal study of the economic impact of the 1986 tax reform act. "We can never be entirely sure because we don't know what would have happened without the tax act."

Even so, "there are specific things that are hard to imagine being attributed to anything else" other than the tax legislation, said Alan Auerbach, professor of economics and law at the University of California, Berkeley, and Professor Slemrod's co-author on the study of the 1986 reform.

With that in mind, here's a look at the major areas where Mr. Trump claims credit.

The **Stock Market**

The **S**.**&P**. **500 index** rose 23 percent during Mr. Trump's first year in office, an increase surpassed only by Franklin Roosevelt and Barack Obama, both Democrats who took office in the wake of financial crises and **stock market** crashes. Mr. Trump's policies and Republicans in Congress deserve some credit, given that economists expect the cut in corporate taxes to raise company earnings, and stock prices are fundamentally a reflection of earnings expectations.

"There's no question after-tax earnings will be higher" thanks to the tax legislation, Professor Slemrod said.

But the estimated impact on after-tax earnings — a range of 7 to 10 percent, according to most economists — accounts for less than half the **stock market**'s rise over the past year. The rest is because of other factors, which may include Mr. Trump's pro-business outlook, but also many things beyond his control.

Stock market valuations are reaching lofty levels by many measures, and those gains may prove ephemeral if growth doesn't live up to investors' rosy expectations. "The value of the stock market isn't an indicator of the economic health of America," Professor Slemrod noted.

The Economy

Gross domestic product grew by 2.3 percent last year, lower than Mr. Trump's predictions of 3-plus percent, but significantly better than the 1.6 percent growth in 2016, Mr. Obama's last year in office.

As should be obvious, passage of the Republican tax legislation was too recent to have had any impact on those numbers. To the extent that expectations of tax reform fueled investment decisions, they may have had some effect, but that's nearly impossible to measure.

The first real clues will come next year, when 2018 gross domestic product numbers are released. The Joint Committee on Taxation estimated that the new tax legislation would raise G.D.P. by seven-tenths of a percent over what it would have been under the old law.

"The economy has been strong, and forecasts for next year have been bumped up due to the tax cut, " said Professor Auerbach. "But there's a lot going on. You won't be able to tell what the impact is from just a few quarters."

Even 10 years after the 1986 law, "it was very difficult to tease out the impact of tax reform on the economy," he said. "The best estimate is it didn't have much effect."

Professor Slemrod agreed. "Tax policy might not be as critical to the rate of business investment as had been thought," he said.

Still, if United States economic growth hits Chinese levels of 7 percent a year or more, which Mr. Trump repeatedly has said is attainable, then Republicans will have a "much stronger" basis for claiming credit for it, Professor Slemrod said. But he deemed such an outcome "extraordinarily unlikely."

Wage Growth and Bonuses

Many companies have been doling out bonuses to employees since the tax legislation passed, but "I don't think that tells us anything," Professor Slemrod said. That's because in standard economic theory, labor market conditions dictate employee compensation levels, not cash flow or profitability.

"The labor market was strengthening long before Mr. Trump was elected or the tax bill was passed," Professor Slemrod said. "If companies were going to raise wages anyway to stay competitive, they have a public relations incentive to attribute it to tax cuts."

Wage growth actually slowed during the first year of Mr. Trump's presidency compared with the last year of Mr. Obama's.

Mr. Auerbach added that given the length of the recovery and low levels of unemployment, many economists "have been wondering why we haven't seen stronger wage growth" as competition for labor heats up. "Now we may be starting to see it."

Much the same can be said about unemployment, which fell to 4.1 percent from 4.7 percent during Mr. Trump's first year as president, and which also reflects the tight labor market conditions that have been developing for years. The unemployment rate fell much more during the Obama years (three full percentage points, from when Mr. Obama took office until when he left), which would be expected given the severe recession he inherited.

In any event, it's far too soon to evaluate Mr. Trump's impact on the labor market. Economists generally agree that at least some of the Republican tax cuts will flow through to workers, although there are widely differing projections about how much, and most say the largest share will go to shareholders in the form of dividends, stock buybacks and higher share prices. Professor Slemrod said we may never know for sure, but "in five or six years we may be able to tell if some of the more extreme claims are reasonable."

Interest Rates and Inflation

It's interesting what President Trump didn't claim any credit for: low interest rates and inflation. Perhaps that's because they're moving upward, although slowly, and pose the biggest threat to the economic indicators he extolled. (On Wednesday the Federal Reserve kept its benchmark rate unchanged after raising it three times during the last year.)

Unlike the 1986 tax legislation, which claimed to be revenue-neutral, the latest Republican bill is a huge tax cut. The Joint Committee on Taxation estimated that the new law would add just over $1 trillion to the deficit over the next decade. It predicted higher interest rates as a result, which it estimated would cost the Treasury an additional $66 billion in debt service costs.

Some supporters of the tax law contend that economic growth will come so quickly that increased tax revenue will more than make up for the cuts. The actual impact on the deficit won't be evident for at least a year, but the rising deficits that followed tax cuts in 1981 forced Republicans to raise taxes in both 1982 and 1984.

Interest rates are already trending higher. Both Professors Auerbach and Slemrod agreed that rates are likely to rise further and would be an important measure of the impact of the tax legislation and Mr. Trump's economic policies. If they rise faster than at the cautious pace the Federal Reserve has projected and investors expect, that could bring the **stock market** rally to an abrupt end. Higher-than-expected rates could also slow the economy, or even tip it into recession.

How sensitive the **stock market** is to interest rates was on display the same day as Mr. Trump's speech, when shares plunged on fears of higher rates after the **10**-**year Treasury** yield rose above 2.7 percent; that's still very low by historic standards, but higher than when Mr. Trump took office.

The big tax cut is a large economic stimulus, and "right now stimulus is a danger," said Professor Auerbach, given that there is nearly full employment and already-strong economic growth.

We'll know a year from now whether the Federal Reserve stuck with its projected three increases in rates this year, and whether any exceeded quarter-point increments.

The bottom line: Presidents tend to get credit (or blame) for whatever economies they preside over, but it's far too soon to evaluate Mr. Trump's long-term impact. Even after years have passed, Professor Slemrod said, "We'll never know with 100 percent certainty."

* First Trump State of the Union Address Makes Appeal for Unity

* Banks Are Big Winners From Tax Cut

* U.S. Economy Grew at 2.6% Rate in Fourth Quarter

President Trump, in his State of the Union address, tied much of the economy's strength to his sweeping tax bill. Economists are still debating the impact of Ronald Reagan's 1986 tax legislation. | Gabriella Demczuk for The New York Times | President Trump likes to take credit for the rise of the **stock market**. It surged after he was elected in 2016 and has reached record highs. He has mentioned its performance at least 25 times this month alone. | By CHRIS CIRILLO

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