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Stocks Log Worst Quarter Since '09

By MATT PHILLIPS And JONATHAN CHENG

Stock markets ended a turbulent quarter on a sour note on Friday, with shares falling sharply amid investors' growing despair about political efforts to deal with the monumental challenges facing the world economy.

The Dow Jones Industrial Average dropped 2.16% on Friday, ending the quarter down 12%—its worst percentage decline since the first quarter of 2009. Stocks in Europe and Asia also fell.

The selloff capped a dismal quarter marked by anxiety about the European sovereign-debt crisis, a U.S. economy flirting with a double-dip recession, and signs that hitherto fast-growing economies such as China are slowing down. Even some famed safe havens failed to perform—gold tumbled toward the end of the quarter, and the Swiss franc also dropped.

"I'd like to forget all about it," said Randy Frederick, director of trading and derivatives at Charles Schwab in Austin, Texas. "It was an ugly quarter, and it started right after the quarter began. There was a whole string of things. When the market might have wanted to go higher, something always seemed to come along to squash it."

The onslaught of bad news, coupled with periodic flashes of optimism, led to one of the most volatile periods ever for stocks. On Friday, the Dow plunged 240.60 points to 10913.38, after big gains earlier in the week. That was the 18th time the Dow moved by more than 200 points in the quarter. In August, it swung by more than 400 points in four consecutive days.

Many investments, from U.S. stocks to crude oil to some emerging market currencies, had their worst quarter since the dark days after Lehman Brothers Holdings Inc. collapsed in 2008. For many investors, the period was reminiscent of those times, marked by worries about the health of banks—this time, primarily in Europe—and a sudden loss of confidence.

Financial stocks were among the hardest hit during the quarter, with many banks falling 25% or more. Morgan Stanley shares tumbled 10% on Friday, and have lost more than 40% of their value during the quarter, amid continued rumors that the bank is exposed to debt of troubled European nations.

Wall Street strategists have reduced their forecasts for growth and company earnings, and investors are ratcheting down expectations for the stock market this year.

Ominous signs abound. Economic data out of China, the key engine for the world economy, is increasingly bleak. Fresh numbers on Friday indicated the country's manufacturing sector
Stocks closed out the worst quarter in more than two years with a triple-digit dive in the Dow Jones Industrial Average, which shed 240 points. Paul Vigna has details on The News Hub.

May have shrunk slightly in September. Leading indicators for the world’s economy, such as China’s stock market, copper prices and crude oil, have tumbled.

The third quarter began on a cautious, but relatively upbeat note. But investors were quickly hit by a barrage of worrisome events. Economic data early in July showed the U.S. recovery was slowing, and policymakers in Washington took the country to the brink of default in early August. Then Standard & Poor’s downgraded the U.S. credit rating, sparking a rush out of U.S. stocks.

At the same time, Europe’s debt troubles deepened, and more recently, the troubling signs emerged about China, raising new doubts about future demand for commodities and other goods.

Investors fled to safe havens. U.S. Treasury debt had its best quarter since the first quarter of 2008. Treasurys maturing in 10 years or more returned 23% during the quarter through Thursday, according to Barclays Capital index data. The yield on the 10-year note tumbled 1.23 percentage points during the quarter. Late Friday, the yield was still below the psychologically important 2% level, at 1.929%. The Japanese yen and U.S. dollar also rose.

Some investors are taking some solace in the fact that the third quarter, historically, has been the worst of the year, and the fourth quarter is typically the best.

"People are finding it increasingly difficult to be optimistic, but I’m hopeful that history will play itself out again," said Charles Schwab’s Mr. Frederick. "I don’t think we’re going to get out of this slump in October, but I see that in November and December."

Investors are now turning their sights to corporate earnings, he said.

So far, earnings have held up well throughout the turmoil, and many investors are hoping for more of the same.

Companies will start releasing their third-quarter reports in coming weeks, and, perhaps more importantly, will give their outlook for profits and the economy.

The Dow’s September decline capped its fifth straight month of losses, the longest such string since the six months ended February 2009. March 2009, however, marked the beginning of a two-year rally.

But some stock-market strategists, after analyzing the relative performance this quarter of individual market sectors, are not optimistic about a rally.

Gina Martin Adams, an equity strategist for Wells Fargo Securities, says some so-called defensive sectors, such as utilities and consumer staples, vastly outperformed the rest of the stock market.

She says that shows that even if investors decide to buy stocks, they are being extremely cautious.

That may be "an ominous indicator of where investors see the economic potential in the next several months," she says. "Investors have been shunning risk in favor of more defensive components of the index."

—Aaron Lucchetti and Brendan Conway contributed to this article.

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