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U.S. MARKETS

U.S. Stocks Drop as Treasurys Flash Warning Signal

The yield on the U.S. 30-year Treasury note touches a record low

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U.S. stocks slumped and Treasury markets sent a new recession signal Wednesday after weak German and Chinese economic data stoked fears of an impending global slowdown.

The Dow Jones Industrial Average dropped more than 650 points, or 2.5%, in midday trading, while the yield on the U.S. 30-year Treasury bond fell to a record low.

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The drops erased the optimism sparked a day earlier when the Trump administration abruptly suspended plans to impose new tariffs on goods from China and suggest the volatile swings that have defined trading in August are showing no signs of easing.

Trade tensions between the U.S. and China, uncertainty about the Federal Reserve's interest-rate policy and signs of slowing economic growth have spurred weeks of turbulence that have rippled through the stock, bond and currency markets.

In the Treasury market, the yield on the U.S. 30-year Treasury bond touched 2.018%, below the previous intraday low of 2.094% in July 2016, according to Tradeweb.

Meanwhile, yields on the 10-year Treasury note briefly fell below two-year yields for the first time since 2007. This kind of inversion between short and long-term yields is viewed by many as a strong signal that a recession is likely in the future.

"Whether we go into recession now or we don't, it's not a good sign," said Michael Farr, president of investment firm Farr, Miller & Washington. "You're going to see investors temper their enthusiasm more seriously today."

Timing is everything, though, and markets tend to keep moving higher immediately following a yield-curve inversion. Since 1978, the S&P 500 has risen 13%, on average, from the first time the spread inverts on a closing basis to the beginning of a recession, according to Dow Jones Market Data.

This latest inversion is particularly concerning given it comes on the heels of the Fed cutting short-term rates last month. Many traders and analysts are now looking for additional intervention by the Fed to extend the economic expansion in the U.S.

Expectations for further rate cuts by the Fed jumped Wednesday morning, with Fed-funds futures showing a market-implied probability of nearly 20% that the central bank cuts rates by 50 basis points in September, up from 4% a day ago.

"The Fed doesn't have the cure for an economic slowdown or recession," said Kristina Hooper, chief global market strategist at Invesco. "But I do think the Fed has the antidote for the stock market selloff."

The Federal Reserve's preferred measure is the difference between 10-year and three-month yields, which have consistently shown this kind of recession risk signal since late May.

Though U.S. Treasury yields have fallen precipitously, they remain higher than the debt on most developed countries around the world. Yields are negative in Japan and much of Europe, sending investors to piling into U.S. bonds and sending prices higher and yields lower.

"Investors globally have no where else to go for yield," said John Brady, managing director at brokerage R.J. O'Brien & Associates.

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The S&P 500 and Nasdaq Composite declined 2.4% and 2.8%, respectively, after the indexes rose by similar percentages Tuesday. Energy companies led the declines as the price of U.S.-traded crude oil dropped more than 3.5% in recent trading.

So far this month, the S&P 500 has posted five swings of at least 1% and is on track for its sixth. During this period, the benchmark index has dropped roughly 5% from its late-July closing record.

Market swings tend to be exaggerated when trading is slow. Stock- and bond- trading volumes have been lower than normal this August, JPMorgan Chase analysts said in a recent note. It isn't unusual to see swift drops this time of year. In August 2011, the stock market tumbled after the Standard & Poor's downgraded U.S. Treasury debt, and in August 2015, U.S. stocks tumbled in tumultuous trading after Beijing's unexpected move to devalue its currency.

Wednesday's moves came despite the White House abruptly changing its policy on Chinese tariffs Tuesday, delaying a round of extra charges from September until December. The delay helped put off concerns that the U.S.-China trade war would have knock-on effects for consumers and domestic demand, although they haven't gone away completely.

Elsewhere, European stocks fell after data showed the German economy shrank in the second quarter. The Stoxx Europe 600 was down 1.6%, while the German DAX dropped 1.9%.

Germany's economy contracted by 0.1% in the second quarter due to further declines in exports, and the latest data mean that average quarterly growth has been zero since the third quarter of 2018, according to ING.

The data put pressure on the German government to stimulate the economy through tax cuts or public spending, and the yield on the 10-year German bund touched a fresh record low of minus 0.645%, according to Tradeweb.

The debilitating effect of trade tensions also was visible in Chinese data, as value-added industrial production in the country grew 4.8% in July, significantly lower than the 6.3% increase in June and below expectations of 5.9% growth.

Still, Asian stocks rallied on the tariff delay, with shares in Shanghai up 0.4% and Japan's Nikkei up 1%. Hong Kong's Hang Seng was up nearly 0.1% as the city continued to struggle with protests and violence.

China reported a raft of weak economic data, adding to evidence that the world's second-largest economy is slowing further. Above, containers are moved at a port in Shanghai. PHOTO: ALY SONG/REUTERS

—Caitlin Ostroff contributed to this article.

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