MARKETS

U.S. Stocks Have Been an Anomaly in Global Markets. Not Anymore.

The factors that helped U.S. stocks to solidly outperform other global equity markets this year faded sharply last week

Traders monitor volatile New York Stock Exchange activity on Friday. **PHOTO:** MICHAEL NAGLE/BLOOMBERG NEWS

By Steven Russolillo and Mike Bird

Oct. 14, 2018 9:00 a.m. ET

For months, U.S. stocks powered higher to records while most of the world's markets crumbled, a divergence that analysts and investors said wouldn't last.

It didn't.

The factors that helped U.S. stocks to solidly outperform other global equity markets this year—a booming tech sector, and seemingly little concern for the pace of the Federal Reserve's interest rate increases—faded sharply last week, when a sudden selloff left the S&P 500 down 5% for the month.

Those trends have dogged emerging markets around the world throughout 2018. The impact of escalating trade tensions between the U.S. and Chinese governments on the global economy has also hit stocks outside the U.S. hardest. Last week, the International Monetary Fund lowered its global growth forecasts for this year and 2019.

Stocks in China and Hong Kong fell further into negative territory last week, while European indexes slumped. A widely quoted gauge of emerging markets has fallen deeper into a bear market—considered a drop of at least 20%. Stocks in the index have fallen by 6.5% in October alone.

Such concerns previously failed to sway U.S. markets much: As recently as Oct. 3, the S&P 500 was up 9.4% for the year and near its all-time high, even as most other international indexes were in the red. Now, the S&P 500 is up just 3.5% for the year.

"We have seen a rapid shakeout of very crowded and over-owned U.S. assets," said Chris Weston, head of research at Pepperstone Group Limited in Melbourne. "Statistically, it feels as though convergence is due," he said, between equities in the U.S. and the rest of the world.

Much of the gap in global equity markets this year has developed in the tech sector. In the U.S., the biggest internet and consumer stocks like Netflix Inc., Amazon.com Inc. and Apple Inc. are still up 77%, 53% and 31% for the year, respectively, even after recent selloffs.

But last week, technology shares led the selloff in the U.S. In fact, tech and consumer stocks like Amazon and Netflix, accounted for around half of the entire fall in U.S. stocks since Sept. 20, according to analysts at BNP Paribas Asset Management.

In contrast, stocks of the largest Chinese tech companies have been big losers. At one point through Thursday, Tencent Holdings Ltd. had wiped out more than $250 billion in market value from its January record high. That decline alone was bigger than all but 15 of the companies in the S&P 500.

Other Chinese tech giants such as Baidu Inc. and Alibaba Group Holding Ltd. , both of which are listed in the U.S., are down 13% and 15% respectively for the year. U.S.-listed Chinese e-commerce giant JD.com Inc. has lost 41% of its market value this year.

The ratcheting up of the U.S.-China trade dispute in recent weeks has brought renewed scrutiny of the global technology supply chain. The potential vulnerabilities and security risks that it entails has been one of the main reasons hurting U.S. tech stocks of late.

"It is one thing to be worried about China slowing or toying with the supply chain for negotiating purposes," said Michael O'Rourke, chief market strategist at U.S. brokerage firm JonesTrading. "It is a whole new level of escalation for [China] to infiltrate it."

"The market has woken up to these risks," Mr. O'Rourke added, referring to how investors have rotated out of U.S. tech stocks recently and gravitated toward companies deemed likely to do better in tougher economic times, like utilities providers.

Historically, most periods of divergence between U.S. and global markets have lasted for about half a year, and have involved emerging markets playing catch up, according to Goldman Sachs analysts. One notable period in which U.S. markets fell and became more in line with the performance of emerging markets was in 2001, after the bursting of the dot-com and tech bubble in the late 1990s, Goldman said.

Mohamed El-Erian, chief economic adviser at Allianz and former chief executive at PIMCO, said the recent U.S. selloff could signal a shift in the market's main drivers.

"The example that I'd use is changing the engines of a plane midflight," he said. "Even if the new engine is a better engine, it's bumpy. We're transitioning from a market led by central banks to one where fundamentals dominate."

He dismissed the notion that U.S. markets are poised to converge with the rest of the world. Most major stock markets have fallen short of the S&P 500 since it bottomed in March 2009 amid the financial crisis.

"U.S. markets outperform both on the way up and the way down," Mr. El-Erian added.

Write to Steven Russolillo at steven.russolillo@wsj.com and Mike Bird at Mike.Bird@wsj.com

Appeared in the October 15, 2018, print edition as 'U.S. Feels Impact of Woes Weighing on Global Stocks.'