U.S. stocks drop most since December

(Reuters) August 5, 2019**- U.S. stocks fell the most since December on Monday after China allowed its currency to weaken beyond a key threshold, signaling dimmer prospects for a de-escalation in U.S.-China trade tensions.**

MARKET REACTION:

- STOCKS: S&P 500 index down 2.87%; Nasdaq off 3.45%; Dow Jones Industrial Average down 2.85%

- BONDS: Yields fell, with the 10-year <US10YT=RR> Treasury yield dropped below 1.75% to the lowest since November 2016

- FOREX: The dollar index lost ground, led by a big surge in the euro <EUR=> and Japanese yen <JPY=> but is up against China's yuan <CNY=> and other emerging market currencies

COMMENTS:

BERNARD BAUMOHL, MANAGING DIRECTOR AND CHIEF GLOBAL ECONOMIST, THE ECONOMIC OUTLOOK GROUP, PRINCETON, NEW JERSEY:

“The most likely reason for the sell-off was the disappointing numbers that came out on service sector, which has been slowing. The reason that’s concerning is that up this point the economy’s been like a rowboat with only one oar – the service sector. The service sector and consumers were the primary forces that were keeping the economy out of trouble but now we’ve got some disappointing numbers on service activity in the U.S. And if we have both manufacturing and services slowing down, that raises the specter of a more severe economic downturn and increases the risks of a recession, perhaps early next year.”

“And then with the yuan finally breaking past 7. It looks like we’ve entered a new stage in the trade war that makes it even more unlikely that the U.S. and China will reach a trade accord in the near future. In fact, if anything, the weakness in China's currency suggests that negotiators in China may be content to stall the talks until after the election.”

“It’s hard to know what Trump wants. But I believe the reason the Chinese are willing to stall is they are seeing in the polls even from Fox that Trump may lose the upcoming election. And also Chinese negotiators are interpreting that Trump’s criticism of the Federal Reserve, that it reflects his concern that the economy may be in trouble if the trade war continues."

“This in an important moment and the outlook is so murky, this is a time to preserve capital to be cautious. In this environment it’s hard to justify spending to shareholders when the outlook is so unclear.”

PETER CARDILLO, CHIEF MARKET ECONOMIST, SPARTAN CAPITAL SECURITIES, NEW YORK:

“The market is down obviously on the China news which basically devalued its currency. This of course is creating anxiety over the escalation of the trade war and I think that this could be the beginning of a currency war that would obviously mean a prolonged trade war if that were to happen. And so I think the selloff is accelerating and we could probably find some initial support around the 2825 level on the S&P but you know the fact that China is retaliating with its currency and also halting new U.S. agricultural purchases is a negative sign for the market which means that this market can probably fall further but there should be some initial support to get a short-term bounce and then probably a resumption of the sell-off.”

STEPHEN MASSOCCA, SENIOR VICE PRESIDENT, WEDBUSH SECURITIES, SAN FRANCISCO:

"Clearly, the news from China is what's causing all of this. Today, the selling is more full-throated. Technology is getting hit pretty good. It's all across the board. I don't see any one thing in particular. Everything is very broad based."

"I was surprised when we saw the original tariff news from Trump, and the Chinese response was pretty severe. I think Trump will back off until after the election.

"We're all the way back to where the market was back in early June. It's not like we're making any new lows. At the end of the day, I don’t think that we’ll rally back too much.”

"At some point, I think Trump will find a way to back pedal. I don’t think we’ll see a full-throat trade war until after the election. If that leads to a temporary decline in the economy and the market, and at the same time there’s an election, I don’t think that plays well for Trump.”

SEEMA SHAH, CHIEF STRATEGIST, PRINCIPAL GLOBAL INVESTORS, LONDON:

“We now need to prepare ourselves for a sharper U.S. equity market correction as investors reprice the risk to the economy from the trade war – and the stronger U.S. dollar. Certainly, the Federal Reserve will now be under severe pressure to cut policy rates again at the September meeting to offset the downside impact.”

“How long the equity market correction will last depends on the Fed’s response and the trade war’s longevity and severity. It surely is not in President Trump’s interest to have a deep and sustained equity market correction, in turn precipitating an economic slump, with the 2020 U.S. Presidential elections fast approaching.”

MONA MAHAJAN, U.S. INVESTMENT STRATEGIST, ALLIANZ GLOBAL INVESTORS, NEW YORK:

"This correction may be a little extended. There's a bit of a vacuum of news right now. Earnings season is winding down and the next Fed meeting isn't until September. The news headlines filling that void are on trade and what might happen between now and September. There's a lot of uncertainty there.

"Our view going into the Fed meeting was to be defensive, to be cautious and maybe take profits and raise cash if you can. Now, we're looking for at least a 5-10% correction here."

ANDRE BAKHOS, MANAGING DIRECTOR, NEW VINES CAPITAL LLC, BERNARDSVILLE, NEW JERSEY:

"Today's move (in the yuan) puts added pressure on the equity markets globally. Nobody likes this uncertainty. The ramifications currently are unknown so it’s anyone's speculation as to how this all ends up playing out. The markets need some stability. These are the main things driving the market right now.

"Earnings are still coming out but investors are more concerned with the macro picture, especially with China and U.S., as they say it’s a heavyweight battle and all eyes are on this and China's move to me signals that they are not going to give in on the trade part right now. So this sort of takes any optimism out of the market that there will be a quick fare resolution to the trade. So pressure is on China and the U.S. to do something. Investors are taking a risk off position. So, the market is getting defensive currently.”

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