THE WALL STREET JOURNAL. ONLINE
MARKETBEAT
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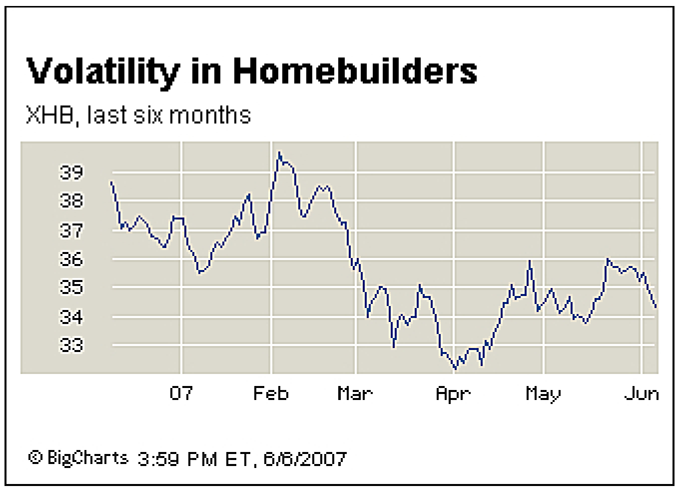
June 6, 2007, 4:41 pm

Four at Four: An Ugly Day

Posted by David Gaffen

Stocks endured a terrible session today on worries about rising labor costs and interest rates, reigniting concerns about inflation, which had finally dissipated in the past few weeks after a spate of better-than-expected economic reports. In two days the Dow has managed to shave off more than 200 points from its record closing high and put together its largest two-day decline since March 12/13, when stocks were still burning from worries in China. Today's market isn't fretting about China — but investors are starting to reassess the value of equities when viewed against bonds in light of rising interest rates.

Speaking of rising interest rates, a bit of the pressure on the dollar of late comes in part because interest rates elsewhere are looking solid, particularly as the other major world central banks (such as Australia, the eurozone and Great Britain) continue to move in the direction of tighter policy, while the U.S., for the time being, sticks with what it's got. **With 10-year British gilts trading at 5.31% and the Australian 10-year at 6.12%, the 10-year Treasury is less attractive at 4.98%.** In England, Germany and Switzerland, 10-year yields have risen 0.57 percentage point, 0.52, and 0.61 percentage point, respectively, compared with just a 0.28 percentage-point increase in the U.S. 10-year note.



Housing slump

After a few weeks of viewing news through the rose-colored prism, the greater wisdom of the equity market seems to be toggling between those and hazy, gray spectacles. The economy is seemingly rebounding from a slow first quarter, and consumer spending remains on track for a solid, if not spectacular, second quarter, and yet the stock market has been all about the malaise lately — even though federal-funds futures contracts have reflected reduced odds of rate cuts for some time (Mr. Bernanke's views this week were hardly revelations). **Maybe, for some, it's the right time for stocks to pause** anyway. "I do hope this is a speed bump that drags us down 5% to 6% — I would see it as a positive," says J.J. Burns, president of investment advisor J.J. Burns & Co. in Melville, N.Y. "It would give us a holding spot to evaluate what's out there."

It was another bad day for homebuilders, thanks to a gloomy announcement from the National Association of Realtors, which seems to be catching up to the rest of America in terms of its assessment of the real-estate industry, finally, after several months of blind cheerleading. The NAR now expects existing home sales will fall 4.6% this year, compared with its previous forecast of a 2.9% decline, and new home sales will be down 18.2%, compared with an earlier forecast of a 17.8% drop. The SPDRs S&P Homebuilders ETF lost 2.2% on the day, continuing a decline after hitting the 36 ceiling in late May, a level that's served as resistance. At some point, housing will regain its footing (perhaps long before NAR figures it out), but with interest rates on the rise, the glum reaction from investors isn't exactly hard to understand.