Wild swings on Wall Street

Nick Beams
7 February 2022

The wild swings in the price of major tech stocks on Wall Street last week point to continued turbulence in financial markets as central banks start to lift interest rates in response to rising inflation.

The gyrations were highlighted by the movements in the price of the shares of Meta (the parent company of Facebook) and Amazon. On Thursday, Meta lost 26.4 percent of its market value, $230 billion, the biggest single-day loss by any company in history.

This was followed on Friday by a move in the other direction when Amazon shares rose 13.5 percent, adding $190 billion to its market capitalisation, to record the biggest-ever single day market gain by a company.

Summing up the sense of bewilderment among market pundits, *Wall Street Journal* columnist James Mackintosh wrote: "Uncertainty about the future of the economy in general and the tech sector in particular are (sic) extremely high. In short, nobody knows anything."

The immediate cause of the dramatic Meta decline was the revelation that Facebook is losing subscribers to TikTok among younger people. As well, changes by Apple in the use of its apps, making it more difficult for Facebook and others to target ads, were expected to cost it $10 billion in 2022.

The loss of Meta's market value was equivalent to the total market value of the leading chip maker Intel and greater than that of McDonald's.

After rises in the first three days of last week, the S&P 500 index fell 2.4 percent, its biggest drop since February last year, taking its decline for 2022 to 6.4 percent. The market then rose marginally on Friday to record its best week for the year but could well slump again this week.

Last week's swings were not confined to Meta. Another social media company, Snap, also fell 23 percent on Thursday because of the changes in Apple's policy. It then bounced back 50 percent in after-hours trade after it announced its first-ever quarterly profit and said it was making progress in devising ways in overcoming the effects of the new Apple policy.

The changes by Apple were introduced last April when it altered iPhone software to require apps to ask users whether they wanted to be tracked. The effect of the move is to limit the ability to gather data through apps that are used to target advertising.

Other companies to have been hit with major swings in their stock prices include Netflix, due to the rise of other online streaming services, and PayPal.

A major reason for the violent swings in the hi-tech companies, produced by relatively small changes in their economic environment, is because so much of the investment in them is highly speculative. Their share value is not based on present returns—often they are making only small profits or even a loss—but on expectations of what they will make in the future. So small changes in their outlook can produce major swings in their stock price.

Conversely, one of the reasons for the rise in Amazon shares, after it had experienced a significant decline of 8 percent, was the lift in the subscription rate for its Prime streaming service and the belief it could contain rising costs for labour and other inputs.

A major factor in the rise and rise of tech stocks over the two years of the pandemic has been the continuous flow of ultra-cheap money from the Fed, which has more than doubled its asset holdings since March 2020 from the already record level of $4 trillion to just under $9 trillion.

But with inflation on the rise—it is now around 7 percent in the US and over 5 percent in the UK and the eurozone—the central banks are moving to tighten monetary policy. This is to try to suppress wage demands by workers to compensate for the major losses in real income suffered over the past two years and the

further losses to come as inflation accelerates.

The shares of tech companies, having been among the major beneficiaries of the flood of cash, are now highly sensitive to indications that it may be withdrawn, even to a limited degree.

This has implications for the market as a whole. As an article in the *Financial Times* over the weekend asked: “Heavy hitting tech stocks have marched investors all the way to the top of a very big hill. Are they about to lead them back down again?”

It pointed out that together the 10 biggest stocks in the S&P 500 index, most of them hi-tech based, accounted for about one-third of the entire market capitalisation of the index, “far above the concentration observed in the previous tech bubble peak of 2000.”

There are other signs of growing instability. The FT has reported that the “huge swings” in stock such as Meta, PayPal and Snap indicate “what investors say has been a dramatic decline in the capacity to transact large batches of shares.”

This tendency is a sign of declining liquidity—the ability to buy and sell an asset, sometimes in large amounts, without having a major impact on the price because of the size of the market.

Patrick Murphy, a partner at the global trading firm GTS, told the FT: “Intraday liquidity has dried up so much. I haven’t seen anything like it since March 2020.”

At that time, financial markets went into their most significant crisis since 2008, with the market for US Treasury bonds undergoing a total freeze that led to the massive intervention by the Fed.

Rocky Fishman, a Goldman Sachs strategist, told the newspaper that liquidity had weakened “substantially” and “weak liquidity ... leaves the potential for outsized market moves.”

Another indication of growing nervousness is the rise in the purchases of credit default swaps, which allow investors to take out insurance against companies defaulting on their debts. They reached $197 billion in January, up from $123 billion in December, to hit their highest level since March 2020.

Corporate debt, along with the stock market, will be heavily affected by the monetary tightening by central banks now underway.

Inflation data for the US this week are expected to show prices continuing to rise at more than 7 percent. Last week, the Bank of England lifted its base rate by 0.25 percentage points, with four of nine members of the governing council voting for a 0.5 percentage point increase, amid predictions that UK inflation will top more than 7 percent in April.

The European Central Bank did not lift its base interest rate at its meeting last Thursday, despite inflation running at more than 5 percent. But ECB president Christine Lagarde adopted what was described as a “hawkish” tone at her press conference, refusing to repeat earlier assurances that interest rates would not rise in 2022.

In an editorial at the weekend, headlined “Interest rates may have to rise sharply to fight inflation,” the *Economist* noted that with the world’s debts now standing at 355 percent of GDP “firms and households were more sensitive to even small rate rises” and “fighting inflation could put the world in a slump.”