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Recession fears, rising oil prices send markets into tailspin

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It's been a long time since a year started as miserably as this one has.

The Standard & Poor's 500 stock index posted its worst-ever start through the first five trading days of the year and was on track to post another sharp loss Wednesday before a buying surge late in the day lifted the market into positive territory.

The S&P 500 rose 18.94 points, or 1.4 percent, to close at 1,409.13.

For the year so far, the index is down 4.03 percent, the sixth-biggest percentage loss posted in the first six trading days of a year since S&P started keeping track in 1928.

The Dow Jones industrial average, which had been down nearly 90 points on Wednesday, closed up 146.24, or 1.16 percent, at 12,735.31.

There was not much good news to explain the market's bounce, leading pundits to pin it on bargain hunting.

In fact, the news was mostly bad, as it has been all year.

Markets have been spooked by the frightening combination of rising oil prices and a slowing economy.

Crude pierced $100 a barrel on Jan. 2, but has since dropped to $95.67.

On Friday, the government announced a shockingly large jump in the unemployment rate to 5 percent from 4.7 percent, suggesting that problems in the housing and banking sectors could be spreading throughout the economy.

Underscoring such fears, a team of Goldman Sachs economists released a report Wednesday saying a recession "has now arrived, or will very shortly." They expect the U.S. economy will "contract modestly through late 2008, followed by a gradual recovery in the course of 2009." Nevertheless, they say they are "quite optimistic about the economy's longer-term prospects."

The Goldman forecast set off an early round of selling Wednesday, as did a report from mortgage giant Countrywide Financial saying that almost 7 percent of home loans it services were delinquent last month, up from 5 percent in December 2006. Countrywide shares fell 6.4 percent on the news. On Tuesday, the company battled rumors that it might file for bankruptcy. Its stock is down almost 90 percent since February.

On the bright side, chemical-maker DuPont said Wednesday that it expects its 2007 earnings to be at the upper end of its forecast and it also boosted its 2008 outlook.

After the market closed, Alcoa reported fourth-quarter earnings that beat analyst estimates. The aluminum-maker is closely watched because it is an economically sensitive company and the first one in the Dow average to report earnings.

As recession fears have grown this year, investors have been selling economically sensitive companies. The S&P materials index, a subset of the S&P 500 that includes Alcoa and DuPont, is down 4 percent. The S&P industrials index is down 5.9 percent and the technology sector is down almost 8 percent.

Consumer discretionary stocks are also down 6.8 percent on average because people usually can defer spending on cars, appliances,

vacations and such when the economy turns down. The financial sector is down 7 percent this year because investors fear that investment and commercial banks will take additional write-offs related to mortgages and structured loan products.

Investors, meanwhile, have been buying defensive industries that historically have held up better during recessions. The S&P health care, utilities and consumer staples indexes are all up this year. The thinking is that no matter how bad the economy gets, consumers will still pay for things like drugs, doctors, heat, water, food, beer and cigarettes.

Eric Bjorgen, a senior analyst with the Leuthold Group, says his firm believes a recession began in the fourth quarter of 2007.

"My guess is, we're not going to see anything particularly deep, more of a garden-variety recession that lasts several quarters to a year or so," Bjorgen says.

He predicts the stock market, which has already fallen more than 10 percent from its peak last year, will tumble 20 percent before turning up.

He says stocks usually take off after they have fallen to a point where their price-earnings ratio is roughly equal to a long-term median of around 16.5 percent. The P/E ratio for the S&P 500 is around 17.8 today, suggesting that stocks have farther to fall.

David Tice, manager of the Prudent Bear mutual fund, is even more negative.

He foresees a "severe recession," with stocks falling as much as 60 percent.

"Everyone has patted the Federal Reserve on the back for avoiding recession, avoiding recession. The problem is, we should have taken mini-recessions along the way," he says.

Every time the economy slowed, the Fed intervened by slashing interest rates. "What they did is like the hair of the dog remedy. Giving someone another shot of tequila. It means the next recession is bigger," he says.

Tice says the economy is slowing not just in the United States but worldwide. He says the Baltic freight index, which gauges the global seaborne dry commodities trade, has been falling for seven weeks.

"China is an accident waiting to happen with its stock market. Europe is slowing down. Singapore had a decline in the fourth quarter. The U.S. consumer has been the driver globally. We borrowed up to our eyeballs in mortgage debt," thanks largely to the packaging of home loans into structured finance products sold globally.

These home loans were taken out not just to buy homes but all sorts of other consumer products. Student loans, car loans and credit card balances were also packaged into securities and sold to investors.

But "confidence in structured finance has broken down. Foreigners are not going to be buying the alphabet soup (of debt products) we sold them over the last three or four years," Tice says.

The Federal Reserve is expected to cut rates again when it meets at the end of this month, if not before. But rate cuts will have limited impact as long as global investors are unwilling to buy our loans.

"It's going to get so ugly, people don't have a clue," he says.

Countering such gloom, Bloomberg released a survey of 62 economists on Wednesday that suggests the U.S. "will skirt a recession as consumer spending slows without collapsing." Economic growth will average 1.5 percent in the first half of this year, matching the fourth quarter, according to the median estimate of economists surveyed by Bloomberg Jan. 3-8.

Off to a bad start

The Standard & Poor's 500 index is off to its sixth-worst start since S&P began keeping track in 1928. Here are the biggest losses posted in the first six trading days of a year. Note that a bad start does not guarantee a bad finish.

Year	First six trading days	Full year*
1991	-5.67%	+30.47%
1978	-5.18	+6.38
1982	-4.71	+21.44
1998	-4.40	+28.58
1974	-4.23	-26.39
2008	-4.03	NA

*Total return, including dividends

Source: Standard & Poor's

Playing defense

As recession fears grow, investors are buying into defensive sectors that tend to hold up better during economic downturns and selling those that do worse.

S&P 500 Sector	Year-to-date performance
Health care	3.25%
Utilities	2.99
Consumer staples	0.05
Energy	-2.42
Materials	-4.01
Telecom	-5.76
Industrials	-5.85
Consumer discretionary	-6.76
Financials	-7.38
Technology	-7.97

Source: Standard & Poor's

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