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Stocks tumble on drop in manufacturing activity

A surprise drop in a key regional economic indicator sent stocks reeling Wednesday, with the Dow Jones industrials sliding more than 80 points.

The Chicago Purchasing Managers Index fell to 46.1 in September rather than rising to the 52 that economists expected. The index, considered a precursor to the national Institute for Supply Management index to be released on Thursday, pointed to a Midwestern manufacturing industry that is weaker than had been expected.

The news on the final day of the third quarter punctured a mild stock rally that followed an upward revision in the Commerce Department's reading for the second-quarter gross domestic product. The government said the GDP, the broadest measure of the economy, sank at a pace of just 0.7 percent in the spring. The new reading was better than the annualized 1.1 percent drop that economists were predicting.

But the Chicago PMI data are fresher, and therefore more troubling, than the GDP. And it reminded investors that the economy still has major obstacles to be overcome before a solid recovery can occur.

"The news of the Purchasing Managers Index actually contracting I think really spooked investors on the last day of the quarter," said Peter Cardillo, chief market economist at New York-based brokerage house Avalon Partners Inc. "Considering the unwelcome news, the market is really not behaving all that bad."

In midday trading, the Dow fell 82.75, or 0.9 percent, to 9,659.45. The index had been down nearly 134 points at its low of the day.

The broader Standard & Poor's 500 index dropped 9.18, or 0.9 percent, to 1,051.43. The Nasdaq composite index fell 15.48, or 0.7 percent, to 2,108.56.

About three stocks fell for every one that rose on the New York Stock Exchange, where volume came to 505.3 million shares compared with 451.7 million shares traded at the same point Tuesday.

The purchasing managers index, compiled from a survey of executives in the Chicago area, added to the market's anxiety ahead of Friday's September employment report from the Labor Department.

A snapshot Wednesday on employment showed some modest improvement in the labor market. The ADP National Employment Report found that private sector employment fell by 254,000 in September following a revised loss of 277,000 jobs in August. It was the fewest jobs lost since July 2008.

Traders are waiting to see whether there will be a significant drop in the number of jobs cut nationwide during September. Investors also are concerned about the unemployment rate. Economists predict the unemployment rate rose to 9.8 percent in September from 9.7 percent a month earlier.

The market could have trouble continuing its advance if economic reports don't boost optimism.

Steve Hagenbuckle, managing principal for TerraCap Partners in New York, expects that corporate earnings will likely exceed expectations again in the third quarter and help boost the market.

"The corporate numbers will continue to be met or exceeded so I think we'll continue to run up," he said. "I don't think this is a major pullback."

Even with Wednesday's drop, the stock market has had a robust third quarter as investors have been betting on an economic recovery. However, as the Chicago PMI showed, there are still many vulnerable spots in the economy that can stall the rally that began in March.

Through Tuesday, the benchmark S&P 500 index gained 56.8 percent since hitting a 12-year low in March, and for the quarter, the S&P 500 and Dow were both up more than 15 percent.

Investors also worried about commercial lender CIT Group Inc., which is preparing an exchange offer that would eliminate as much as 40 percent of its more than \$30 billion in outstanding debt, according to The Wall Street Journal, which cited anonymous sources. The exchange give control of the company to its bondholders and wipe out common stockholders, according to the report.

The stock fell 80 cents, or 36.4 percent, to \$1.40.

Meanwhile, bond prices were little changed Wednesday but recovered from earlier losses following the Chicago PMI report. The yield on the benchmark 10-year Treasury note, which moves opposite its price, rose to 3.30 percent from 3.29 percent late Tuesday.

The dollar was mixed against other major currencies, while gold prices rose.

Light, sweet crude rose \$2 to \$68.71 a barrel on the New York Mercantile Exchange.

The Russell 2000 index of smaller companies fell 8.90, or 1.5 percent, to 601.55.

Overseas, Japan's Nikkei stock average rose 0.3 percent. In afternoon trading, Britain's FTSE 100 fell 0.5 percent, Germany's DAX index lost 0.7 percent, and France's CAC-40 fell 0.5 percent.