Small Caps Dropping With Junk ETF Stir Anxiety in Traders

By Oliver Renick
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Declines over the past week in small caps, transportation companies and a security tracking high-yield debt are stirring unhappy memories in U.S. traders.

The Russell 2000 Index has lost 2.4 percent since reaching a five-month high on Nov. 12 while shares in the Dow Jones Transportation Average (TRAN) index are down 0.9 percent. The iShares IBoxx High Yield Corporate Bond ETF (HYG:US) has dropped for six straight sessions, a stretch in which the Standard & Poor’s 500 climbed 0.4 percent.

All three gauges were also slipping in September as the S&P 500 began a monthlong retreat that erased about $2 trillion from U.S. equity values. Concern is rising that losses will bleed from one section of the market into others, said Matt Maley, equity strategist for Miller Tabak & Co. in Newton, Massachusetts.

“Back in September the HYG had already been under-performing for a while, but when it fell hard, it finally affected the stock market,” Maley said, referring to the high-yield-bond ETF’s ticker symbol. “It’s very similar now. Now that the decline is accelerating, it could have the same impact on stocks.”

Losses in the Russell 2000 Index (RTY) of smaller companies were highlighted as far back as April by bears before the Standard & Poor’s 500 Index tumbled as much as 9.87 percent over 26 days ending Oct. 15. From its record on March 4, the small-cap gauge slid 4.1 percent to Sept. 18 while the S&P 500 was rising more than 7 percent to a record.

Small-Caps, Transportation

The S&P 500 has rallied 10 percent since October’s turmoil amid better-than-expected earnings and economic data suggesting the economy is strong enough to overcome a global slowdown. The relative strength indicator for the equity gauge is 69.44, within a point of a level that technical analysts say signals unsustainable gains.

“The best-case scenario for the market right now would be a mid-1 percent to 2 percent pull back to work off the over-bought condition,” Maley wrote in an e-mail yesterday. “If any decline comes on a big pickup in volume and horrible breadth, we could get another scary down draft.”
The Standard & Poor’s 500 Index (SPX) dropped 0.2 percent to 2,048.72 yesterday. The Dow Jones Industrial Average lost 2.09 points, or less than 0.1 percent, to 17,685.73. The Russell 2000 sank 1.1 percent.

The Russell 2000’s decline of 2.4 percent in the past week is the biggest since the five days ending Oct. 13, when the index fell to a one-year low.

The Dow Jones Transportation index hasn’t posted back-to-back gains since the start of the month, and has fallen 0.9 percent from touching a new high a week ago. The gauge lost 6.9 percent in the week before the S&P plunged to its six-month low.

“Maybe this is telling us something because a lot of the time the bond market tends to foreshadow what’s going on,” Mark Kepner, an equity trader at Themis Trading LLC, in Chatham, New Jersey, said via phone. “It’s definitely what we saw earlier this year with small-caps getting hit first with high yield. It’s about risk, and it’s fitting into that pattern.”

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