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Weekly Market Update

Stocks seek to regain footing after another turbulent week

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Article Highlights

- Volatility spikes on global growth concerns.
- Equity investors both want and fear continued low interest rates.
- Risk-averse investors again flock to U.S. Treasuries and other fixed-income sectors.
- Weak German data sparks a selloff in European stock markets.
- The dollar's retreat from recent highs provides no lift to commodity prices.
- History shows that a negative start to October for U.S. equities is often followed by rallies.

October 10, 2014

U.S. equities swung widely during the past week, highlighted by three consecutive trading sessions in which the S&P 500 Index either lost or gained between 1.5% and 2%. The market surged on the October 8 release of the Federal Reserve's September meeting minutes, perceiving a "dovish" tilt in the Fed's expressed concern that the U.S. economy may be vulnerable to slower global growth. That rally reversed dramatically the next day, however, and all major U.S. indexes finished the week sharply lower. Investors remain torn between the desire for interest rates to stay low and the fear that the economic sluggishness that is keeping rates low may deteriorate into outright recession, particularly in Europe. This tug of war fueled a spike in the VIX or so-called "fear" index, a measure of the implied volatility of the S&P 500.

Stocks in Europe and Japan also fell for the week, hurt by worsening German economic data and a stronger yen relative to the dollar, respectively. In China, the Shanghai Stock Exchange "A" Share Index continued to climb, despite the deceleration in Chinese economic growth. The index is now up roughly 13% for the year to date.

Fixed income

Amid weaker European data and the Fed's recognition of global growth risks, investors sought safer havens in U.S. Treasuries and other fixed-income assets. The yield on the bellwether 10-year Treasury note, which moves in the opposite direction of its price, closed at 2.31%, 14 basis points (0.14%) lower than its close on the previous Friday. Based on Barclays indexes, residential and commercial mortgage-backed securities both performed well through October 9, helped by

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limited supply. Investment-grade corporate bonds also realized positive returns, while high-yield bonds posted modest losses.

Flows into emerging-market debt funds were favorable for the weekly period ended October 8, as were flows for high-yield bond and loan funds. Investment-grade corporate bond fund flows were significantly higher than in prior weeks, possibly reflecting movement out of equities by investors seeking the relative stability of bonds.

Current updates are available here. For additional TIAA-CREF insights on markets developments, view our Weekly Market Perspective Video.

The dollar comes off its recent highs amid mixed U.S. data

What little U.S. data was released during the week generally showed an economy in which growth is continuing but not accelerating. First-time unemployment claims were less than 300,000 for the fourth consecutive week—a feat not accomplished since early 2006—and are 21% lower compared to year-ago levels. However, independent surveys of company activity weakened, and forward measures of inflation fell. The dollar retreated slightly from its recent multi-year highs, but that did not help commodities, which continued to trade lower led by oil. A stronger dollar tends to depress oil prices and can hinder U.S. growth prospects by adding to deflationary pressures and making exports less competitive. At the same time, lower oil prices can support growth by providing a stimulus for consumers.

Germany’s weak economic data drives European equity losses

With little U.S. economic data to digest, markets focused much of their attention on weak releases out of Germany, including declines in industrial production, factory orders and trade data. These poor readings are notable because Germany is the eurozone’s largest economy and typically the engine of growth in the region. Some of Germany’s weakness may reflect the impact of Russian sanctions, as well as decelerating import demand from China. The German government has begun a vigorous debate on how to address the country’s economic challenges; one potential outcome may be increased flexibility on the part of the European Central Bank to implement further monetary stimulus, such as full-blown quantitative easing.

While Germany’s latest economic readings warrant caution, some eurozone countries are showing signs of improvement: Spain continues to make progress as its market reforms have begun to have a positive effect, and Italy has tentatively embarked a similar program of labor reforms, which may bode well for future growth. France, however, remains behind the curve in this regard.

Outlook

History shows that a negative start to October is usually followed by rallies. Dating back to 1931, there have been 12 instances in which the U.S. equity market declined by 1% or more on October 1. In 11 of those cases, the subsequent results for the full month of October were solidly positive. Of course, there is no guarantee that the market will follow this pattern in 2014. Nonetheless, based on negative short-term sentiment and the spike in market volatility, the stage may now be set for the S&P 500 to advance again. The key will be earnings, which in the past week have come in better than expected. Going forward, earnings could come under pressure from a stronger dollar and weaker overseas activity.

In fixed-income markets, riskier assets such as high-yield bonds and loans, along with emerging-markets debt, will likely be more volatile, moving in sympathy with equities. The growing sense that economic weakness in Europe and elsewhere could ultimately threaten the U.S. recovery, coupled with negligible U.S. wage growth, make it clear that the Fed will not be forced to raise short-term interest rates anytime soon on the basis of inflation risks.

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