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TIAA GLOBAL ASSET MANAGEMENT

# A softer-than-expected U.S. jobs report dims Fed rate-hike expectations

**WILLIAM RIEGEL, CHIEF INVESTMENT OFFICER, TIAA INVESTMENTS**

**Article Highlights**

- The S&P 500 advances, while European stocks notch a four-month high.
- U.S. Treasury yields tick up in the wake of August's employment numbers.
- August payrolls have tended to lag consensus forecasts, making them prone to upward revisions.
- In our view, a Fed move in September is off the table, and December action is far from certain.
- Although we believe the S&P 500 may exceed the 2,250 level this year (and perhaps 2,400 next year), near-term caution is warranted.

## Equities

In her comments at the Fed's annual Jackson Hole symposium on August 26, Federal Reserve Chair Janet Yellen stated that an improving U.S. economy had strengthened the case for a rate increase. One week later, on September 2, markets anxiously awaited the August jobs release to assess how it might affect the Fed's policy-tightening timetable.

The middle-of-the road report dampened expectations for imminent Fed action, boosting global equities. In light trading ahead of the Labor Day weekend, the S&P 500 Index was primed to extend its modest gains from earlier in the week. Meanwhile, Europe's broad STOXX 600 returned 2.2% for the week (in local currency terms) to reach a four-month high.

Current updates to the week's market results are available here.

## Fixed income

The equity rally in the wake of the jobs report trimmed demand for U.S. Treasuries, sending their prices lower and their yields higher. After hovering around 1.57% for most of the week, the yield on the bellwether 10-year note touched 1.61% in early afternoon trading on September 2.

Returns for non-Treasury "spread sectors" were broadly negative for the week through September 1. High-yield bonds bucked that trend with a small gain.

## The pace of U.S. jobs growth cools in August

After outstripping forecasts for two consecutive months, the U.S. economy missed expectations by adding only 151,000 jobs in August. This wasn't unusual from our perspective, however, as August payrolls historically have tended to surprise to the downside, making them prone to upward revisions. Both the unemployment rate (4.9%) and the labor-force participation rate (62.8%) were unchanged. Payrolls for June and July were revised down by a combined 1,000. Average hourly wages rose 0.1% in August and 2.4% over the past 12 months.

Among the week's other releases:

- The Conference Board's index of **consumer confidence** rebounded in August to its highest level in almost a year, topping forecasts. Consumers' assessment of both current business and labor market conditions improved, as did their prospects for personal income.
- **Consumer spending** increased 0.3% in July, its fourth consecutive monthly gain. With personal income (+0.4%) outpacing spending, the personal savings rate climbed from 5.5% to 5.7%.
- **Inflation,** as measured by the Fed's preferred inflation barometer (the PCE index), was unchanged in July and up a scant 0.8% over the past 12 months. The "core" PCE index, which excludes food and energy costs, rose 0.1% and 1.6% compared to a year ago.
- **The U.S. trade deficit** sank 11.6% in July, to $39.5 billion, down from June's upwardly revised $44.7 billion. While exports rose 1.9%, their largest increase in more than two years, imports declined 0.8%.
- **First-time unemployment claims** edged up by 2,000, to 263,000, while the less-volatile four-week moving average fell, by 1,000, also to 263,000.
- **U.S. home prices** fell 0.1% in June but remained 5.1% higher than a year ago, according to the S&P/Case-Shiller 20-City Composite Index, while **pending home sales** jumped 1.3% in July.
- **U.S. factory orders** rebounded 1.9% in July, their biggest gain in nine months. Moreover, orders for non-defense capital goods (excluding aircraft), which are seen as a measure of business confidence and spending plans on equipment, were up 1.5%.
- **Manufacturing activity** unexpectedly slid into contraction territory, as the Purchasing Managers Index (PMI) published by the Institute for Supply Management (ISM) fell to 49.4. (Readings below 50 indicate contraction.)

## Outlook

While the S&P 500 Index may well rise to and through the 2,250 level this year (and perhaps as high as 2,400 next year), near-term caution is warranted. From a technical standpoint, the equity market is stretched as we head into September, which is known as the worst-performing month of the year. Since 1928, the S&P 500 has delivered negative returns 56% of the time. Moreover, short-term investor sentiment has turned firmly bullish—a contrarian indicator that often presages a market decline.

That said, we believe a pullback represents a buying opportunity. Although the economy's momentum has waned slightly, its overall trend is still positive, with third-party surveys moving higher over the past six months and many economic data releases surprising to the upside. In addition, the equity market's advance has been led by Financials, small-cap stocks, and cyclical industries such as machinery, all of which tend to outperform when the economy is stronger.

As for U.S. monetary policy, hawkish Fed rhetoric prior to the release of the August payrolls report had led markets to raise the odds of a September rate hike to nearly 30%. That figure plunged to about 10% immediately after the release but reversed course later in the day as markets continued to digest the implications of the jobs data. In our view, a September increase is off the table, as the Fed's voting members currently lack consensus on such a near-term move, and even a December hike is far from certain. Moreover, global events with the potential to disrupt financial markets could allow the Fed to hold off until next year.

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