Weekly Market Update

Worries over Ukraine and China reclaim the spotlight

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Article Highlights

- Global equities decline as Ukrainian crisis deepens.
- China's weak economic data continues to weigh on markets.
- U.S. Treasuries benefit from increased demand for safe-haven assets.
- Even accounting for severe winter weather, U.S. growth has been slower than anticipated.
- We have lowered our U.S. GDP growth forecasts for 2014.

March 14, 2014

U.S. equity markets moved lower during the past week, as the crisis in Ukraine and lackluster growth signals in China outweighed some generally positive U.S. economic data. For the week to date through March 13, the S&P 500 Index was down 1.6%, erasing gains recorded in the first week of March and sending the index back into negative territory for the year to date. International equity markets also declined, with returns in Europe, Japan, and the emerging markets ranging from -1.7% to -2.4% for the week through March 13, based on MSCI indexes.

Bonds fared better than stocks in this volatile environment. U.S. Treasuries saw their prices rise and yields fall on increased demand for safe-haven assets. The yield on the bellwether 10-year Treasury, which closed at 2.80% on March 7, was down to 2.65% in midday trading on March 14. Other high-quality fixed-income sectors also recorded gains for the week, while high-yield bonds were essentially flat. Flows into fixed-income funds, including those that invest in emerging-market debt, were generally positive.

Current market updates are available here.

Weather aside, underlying U.S. growth has been slower than anticipated

The U.S. economy has begun to emerge from the winter's deep freeze, and signs point to growth picking up in the coming months. That said, the extreme weather of the past few months clearly had a negative impact on first-quarter growth. Moreover, while we continue to believe that weather, and not fundamental economic weakness, is the predominant cause of the slowdown, underlying growth is not as strong today as we had predicted.

Financial Services

Worries over Ukraine and China reclaim the spotlight

Among the readings released during the past week:

- **First-time jobless claims fell** by 9,000 to 315,000, the lowest level in more than three months and one of the best readings since the end of the recession in June 2009. The four-week moving average of claims, a less volatile indicator, also fell.
- **Retail sales rose** a seasonally adjusted 0.3% in February, their first gain in three months and slightly ahead of consensus expectations. However, retail sales for December and January were revised downward.
- Despite a drop in sales at the wholesale and trade level, **business inventories increased** 0.4% in January, which suggests companies continued to stock shelves and warehouses in anticipation of a pickup in demand.
- **Consumer sentiment fell** to a four-month low in early March, as measured by the Thomson Reuters/University of Michigan index.

Ukraine tops the list of international concerns

After a brief period in which the markets seemed to be shrugging off tensions between Russia and Ukraine, the escalating crisis in the Crimean region of eastern Ukraine again dominated the headlines, fueling global anxiety and sending equity markets lower, particularly in Europe and the emerging markets. The outcome of a scheduled March 16 voter referendum in Crimea could pave the way for the region to secede from Ukraine and rejoin Russia. To some extent, markets have priced in this result. In our view, the likeliest scenario is that Russia will ultimately subsume Crimea despite international objections, and the main question is what, if any, reaction there will be from other countries. If the crisis escalates beyond what the markets currently expect (e.g., if the risk of significant military action increases), then markets would see further fallout.

In China, the focus is on weak economic data and attempts at market reform

A number of lackluster economic releases out of China, including lower-than-forecast industrial production and retail sales, along with government rhetoric that downplayed growth, reinforced concerns about a weakening Chinese economy. The Shanghai Stock Exchange “A” Share Market Index, a generally reliable barometer of China’s economic health, was down 2.6% for the week.

Another development that bears watching from the past week is a bond default by a solar equipment manufacturer—the first company ever to default in the Chinese bond market. China is attempting to reform its markets, and we believe this default is part of the growing pains in that process. If there are no major repercussions from this event, we suspect that more defaults may be in store in the coming months.

Overall, we believe the Chinese economy will grow at roughly the pace projected by the government (about 7.5%), but that the potential for market-moving events and increased volatility will grow as reforms are continued.

Outlook

We expect a rebound in some U.S. data for February and March, but the growth trajectory for the remaining months of the year will likely be a bit slower than we originally forecasted. In part this is because consumer incomes and housing activity have underperformed our expectations. Given these and other factors, we have trimmed our GDP growth forecasts. Our current forecasts for 2014 are as follows:

- 1.8% for the first quarter
- 2.8% for the second quarter
- 2.9% for the third quarter
- 3.1% for the fourth quarter

On an average basis, the economy has been growing between 2% and 2.25%, and we had expected that to move up toward 2.75% by the end of 2014. We now expect a growth rate closer to 2.5%.