Weekly Market Update

Markets remain steady following Fed Chair's latest comments

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Article Highlights

- The S&P 500 Index advances for the week, lifted by strong economic data and earnings.
- High-yield bonds benefit from strong demand and limited supply.
- U.S. housing indicators surprise to the upside.
- Europe's economy remains weak, but we see some encouraging signs.
- Fed tightening is most likely to begin in June of 2015, slightly sooner than previously anticipated.

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Equities

U.S. equities advanced, with the S&P 500 Index fully recovering from its late July-early August slide to close at a new high on August 21. Markets turned more tenuous on August 22, however, as Federal Reserve Chair Janet Yellen spoke from the Fed's annual summit in Jackson Hole, Wyoming. While Yellen's tone was perceived as slightly more "hawkish" than it has been previously, her remarks did not convey a momentous shift in thinking about when and by how much the Fed will begin to raise short-term interest rates.

Despite a Friday slump on signs of a flare-up in Russia-Ukraine tensions, European equities rose for the week. Economic data releases were uninspiring but offered some signs of stabilization. Additionally, the euro continued to weaken, benefiting the region's exporters. The Japanese yen also weakened, helping the Nikkei 225 Index post its second consecutive weekly gain. Led by China, emerging markets continued to perform well. Since bottoming in early February, these markets have risen almost 20%.

Fixed income

U.S. investment-grade fixed-income returns were flat to slightly negative for the week. The yield on the bellwether 10-year Treasury note, which moves in the opposite direction of its price, rose modestly amid an easing of geopolitical worries and broadly favorable U.S. economic releases.

Financial Services

Meanwhile, U.S. high-yield bonds outperformed, supported by strong inflows and limited new supply. Although recent corporate issuance has been lacking, issuance of high-yield bonds and loans, along with investment-grade corporate debt, is expected to be strong in September, at $50 billion and $100 billion, respectively. Emerging debt markets were choppy during the week, as relative calm on the geopolitical front was partly offset by concerns about Argentina's debt problems.

Current market updates are available here. For additional insights on developments in the emerging markets from TIAA-CREF Portfolio Manager Anupam Damani, view the Weekly Market Perspective Video.

Upbeat U.S. economic data is led by housing

The week's U.S. data releases showed an economy that continues to gain traction. Housing, unemployment claims, and manufacturing reports were all favorable.

- **Housing.** The NAHB/Wells Fargo index of homebuilder confidence reached its highest level in seven months, supported by healthy jobs growth and lower mortgage rates. In addition, housing starts and building permits surged 15.7% and 8.1%, respectively, in July, with both measures exceeding an annual rate of 1 million units. Existing home sales also improved for the fourth consecutive month, rising 2.4% in July.
- **Labor markets.** Weekly first-time jobless claims dipped below 300,000 for the third time in the past five weeks, reflecting a pickup in hiring trends. Claims remain at or near eight-year lows.
- **Manufacturing.** The Markit "flash" (preliminary) Purchasing Managers Index (PMI) jumped to 58.0 in August, the best performance by this U.S. manufacturing index in more than four years. (Readings above 50 indicate expansion.) On a regional basis, the Philly Fed manufacturing index rose more than expected to its highest level since March 2011.
- **Leading economic indicators.** The Conference Board's index of leading U.S. economic indicators climbed a healthy 0.9% in July, pointing to further strengthening in the economy later this year.

European indicators disappoint, but there are some hopeful signs

Growth in Europe has slowed, primarily due to weakness in manufacturing and construction. That said, while preliminary readings for Germany's manufacturing and service-sector PMIs both fell in August, they remained above the 50 threshold that signifies expansion. Meanwhile, France's manufacturing PMI slipped (46.5), while its services gauge rebounded (51.1). In our view, there is enough evidence to suggest a stabilization is underway in the eurozone, which could help avert a new recessionary trend and return the region to modest growth.

In his speech at the Jackson Hole summit on August 22, European Central Bank (ECB) President Mario Draghi indicated that he is in no rush to take further stimulative action beyond the measures introduced in June, but that the ECB "stands ready" to do so in light of weak growth and inflation trends in the eurozone. The prospect of such action remains a potential positive wild card for the region.

Outlook

While uncertainties at the macro level persist—including conflicts in Ukraine and the Middle East, the Ebola virus outbreak, and the potential timing and pace of Fed tightening—equity markets have generally been able to push higher. Stronger U.S. economic releases and improved corporate earnings have been key drivers of the market's resilience. Second-quarter results for S&P 500 companies, for example, now show almost a 5% revenue gain and more than 11% earnings growth. In addition, intermediate-term sentiment has remained neutral after peaking in early July, while longer-term measures are still firmly skeptical. These contrarian indicators are one reason we believe the S&P 500 can move higher before a major correction occurs.

With regard to the Fed, our view is that tightening is most likely to begin in June of 2015—slightly sooner than we previously anticipated—with the possibility of an earlier move in March. U.S. equity markets seem accepting of this scenario, evidenced by their mild reaction to Janet Yellen's remarks in Jackson Hole. However, there is a potential fault line between the market's expectations about the pace of Fed tightening and current Fed projections, with the market inclined to see Yellen as more dovish and likely to raise rates slowly. The Fed, in contrast, is focused on a rapidly healing labor market and could raise rates more quickly than the market expects.

If stronger U.S. growth were to shift current market expectations, the result could be disruptive to fixed-income markets, and we could see a sharp jump in rates that in turn would destabilize equities. For now, however, much stronger U.S. growth may be unlikely, given relatively muted economic activity in the rest of the world. Concerns about further weakening in Europe, China, and Japan could temper a rise in U.S. interest rates in the coming months.

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