Weekly Market Update

Central banks fuel an end-of-week equity rally

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Article Highlights

- Equities advance on a surprise Chinese rate cut and the prospect of stronger ECB action.
- The S&P 500 Index ends the week at a record high.
- Fixed-income markets are quiet, with the 10-year U.S. Treasury yield remaining range-bound.
- Japan's prime minister calls a snap election and delays a sales-tax increase.
- Given the U.S. market's extended rally, we would not be surprised to see a correction.

November 21, 2014

Equities

Dovish comments by European Central Bank (ECB) President Mario Draghi and a surprise interest-rate rate cut by China's central bank provided a late-week lift to equity markets. In a November 21 speech, Draghi stated that "we will do what we must do to raise inflation and inflation expectations as fast as possible." Although Draghi has made similar pledges before and as recently as November 6 signaled that further ECB monetary stimulus was on the horizon, this time he suggested additional easing could begin early in 2015. Also, China's central bank cut its one-year deposit rate and one-year loan rate by 25 basis points (0.25%) and 40 basis points (0.40%), respectively, in order to boost the country's cooling economy.

These words and actions from two of the world's largest central banks helped European and U.S. equities add to their modest gains from earlier in the week. In China, equities also rallied to end the week, although we are not convinced that the central bank's action represents the beginning of a new interest-rate cycle. Accordingly, China's market response may be less sustainable than Europe's. Elsewhere in emerging markets, equities have yet to respond to economic releases that have exceeded expectations.

Current updates are available here. For additional insights on equity markets from TIAA-CREF Portfolio Manager Susan Kempler, view our Weekly Market Perspective Video.

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Fixed Income

U.S. Treasuries traded within a narrow range during the past week, with the yield on the bellwether 10-year note generally holding between 2.32% and 2.36%. In part, Treasury yields were kept in check by minutes from the Federal Reserve's October meeting showing that the Fed believed near-term inflation will likely be restrained by lower energy prices.

Among "spread products" (higher-yielding, lower-rated non-Treasury securities), returns were generally flat to slightly negative for the week through November 20, based on Barclays indexes. Mortgage-backed and asset-backed securities eked out small gains, while investment-grade and high-yield corporate bonds posted losses.

The U.S. economy maintains its steady pace

U.S. economic data released during the past week was largely favorable:

- The Conference Board's index of **leading economic indicators** increased for the second consecutive month, pointing to relatively strong consumer demand over the near term.
- **The Citi U.S. Economic Surprise Index,** which measures the extent to which economic data readings diverge from consensus forecasts, rose in November, indicating more positive than negative data surprises relative to estimates.
- **Regional manufacturing indexes** also rose in November. The Philly Fed survey index jumped to its highest level in almost 21 years, while the Empire State index rebounded after an October decline.
- In October, **existing homes sales** reached their best level in more than a year, while **homebuilder confidence** hit a nearly nine-year high.

Other indicators were mixed: U.S. manufacturing activity grew at a slower pace in October, based on Markit's "flash" (preliminary) Purchasing Managers Index, although the index remained well above the 50 threshold separating expansion from contraction. First-time unemployment claims, though slightly above forecasts, ticked down, remaining below the key 300,000 threshold for the tenth consecutive week—something that hasn't happened since 2000.

The ECB's moves may provide additional impetus for investing in Europe

Early in the week, European equity markets rose on a report that German economic sentiment had improved for the first time in nearly a year. This closely watched indicator helped ease concerns over the health of the German economy, Europe's largest. Markets retreated on November 20, however, in the wake of a drop in the Eurozone PMI composite index (measuring both manufacturing and service-sector activity) to its lowest level in 16 months. The next day, the ECB's strong easing rhetoric put stocks back on track.

Despite Europe's inconsistent data releases, we believe that the region's economic activity is bottoming, and that the potential for ECB quantitative easing may make an already attractive investment destination even more desirable.

Japanese government responds to unexpected recession

While the S&P 500 was breaking records, Japan's Nikkei 225 Index retreated from its recent seven-year high. On the heels of government data showing that the Japanese economy had unexpectedly slipped into recession, Prime Minister Shinzo Abe called for a snap election in December and postponed until April 2017 a sales tax increase originally scheduled for October 2015. We are cautiously optimistic about Abe's plans to secure a mandate for true economic reform.

Outlook

Since its October 15 low, the S&P 500 Index has been on an extended run, climbing more than 10%. Meanwhile, investor sentiment has become much more optimistic, and 80% of the index's components now trade above their 50-day moving averages. These signals often presage a market pullback, so we would not be surprised to see a correction.

In U.S. fixed-income markets, the recent increase in high-yield corporate bond yields and spreads is likely the result of declining oil prices—a headwind for the many exploration and production companies found in the high-yield universe. We also believe that lower gasoline prices will translate into stronger consumer spending, an effect that is already reflected in the rising share prices of some key retailers and U.S. consumer discretionary stocks.

Lastly, we believe that fixed-income markets will benefit from domestic and international fund flows heading into 2015, as interest-rate increases should be slow and measured.

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