Weekly Market Update

U.S. equities quietly advance in light trading

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Article Highlights

- U.S. equities reach new highs in quiet Thanksgiving week trading.
- Consumer spending and business investment drive upward revision to third-quarter GDP.
- We now forecast annualized GDP growth of 3% in Q4, higher than the consensus.
- Europe and Japan look somewhat brighter, but with potential political caveats.
- Both equity and bond markets are behaving as expected as Fed tightening nears.

November 26, 2014

Equities

As the Thanksgiving holiday approached, U.S. equities continued their climb in very light trading. Foreign equity markets were also generally positive. In the U.S., equity markets have been supported by declining oil prices that have lowered energy costs for consumers and businesses in the second half of the year. As of November 26, it was still not clear whether OPEC would decide to cut production and boost prices.

Fixed Income

The 10-year Treasury yield drifted down during the holiday-shortened week, ending at 2.27% on November 25, its lowest close for the month to date, and trading lower early the next day. For most of November, the yield on this bellwether security has stayed in a range between 2.28% and 2.38%. Meanwhile, sovereign debt yields in Germany, Italy and Spain remain at or near historic lows in anticipation of aggressive monetary easing by the European Central Bank (ECB).

Current updates are available here. For additional insights from TIAA-CREF Global Investment Strategist Dan Morris, view our Weekly Market Perspective Video.

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U.S. GDP growth is revised upward, while other data is mixed

The government raised its estimate of third-quarter GDP growth from 3.5% to 3.9%—an upbeat report that defied consensus expectations of a downward revision to 3.3%. Details of the report showed that consumer spending, business investment in equipment, and inventory growth were all stronger than first reported. Export growth, however, was weaker.

Other data released during the week was mixed to slightly negative, including:

- **Home price appreciation** slowed from 5.6% in August to 4.9% in September on a year-over-year basis, according to the S&P/Case Shiller 20-City Composite Index—in line with our expectations of a 3%-5% annual rise in home prices.
- **First-time unemployment claims** spiked above 300,000 for the first time in 11 weeks, but we are not overly concerned, as the weekly number is volatile. We still expect nonfarm payroll growth to top 200,000 in November.
- **Consumer confidence** fell in November, based on The Conference Board's monthly index, while the final November reading of the University of Michigan/Thomson Reuters **consumer sentiment** index was revised downward but remained at its highest level since mid-2007.
- **Durable goods** orders were disappointing, as the 0.4% growth in October was fueled by a surge in military aircraft orders, while orders for "core" capital goods (a measure of business investment) were down 1.3%. The durable goods indicator is volatile and bears watching.
- **Personal incomes** and **consumer spending** both rose 0.2% in October, in line with consistent growth.
- **New home sales** inched up in October, to their highest annual rate in five months, but **pending home sales** fell.

Foreign economies and markets appear somewhat brighter

Outside of the U.S., we see some encouraging signs, tempered by potential risks:

- In Europe, equities have performed well in anticipation of aggressive monetary stimulus from the ECB, although the market is at a key resistance level that may cap further rises in the near term. While valuations remain compelling, we are mindful of potential risks that may come to bear in 2015, including elections in Greece, Spain and the U.K.
- Japanese voters go to the polls on December 14, with Prime Minister Shinzo Abe seeking the political authority to enact major reforms. We are increasingly optimistic about a favorable outcome.
- In China, the government's steady drip of mini stimulus continues, which so far has been enough to avoid the feared "hard landing" for the country's slowing economy. Chinese equities remain on their upward track.

Outlook

Overall, we are encouraged by the upward third-quarter U.S. GDP revision and now forecast annualized GDP growth of 3% in Q4, higher than the consensus of about 2.7%.

On balance, both equity and fixed-income markets are behaving as we would expect as Federal Reserve tightening nears: spreads on corporate bonds (both investment-grade and high-yield) have widened relative to Treasuries, and large-cap equities are leading small-cap shares. The S&P 100 Index of large-cap stocks, for example, has gained more than 13% year-to-date, while the small-cap Russell 2000 Index is up only a little more than 3%.

Looking ahead, as the S&P 500 Index approaches the 2,100 level, we should see some sort of correction to reset extremely elevated optimistic sentiment. Such a pullback would present a buying opportunity, as we think 2,150 is the next target for the S&P 500 in 2015.

In fixed-income markets, there are effectively only two to three active trading weeks left in 2014, as issuers are mostly funded for the year and secondary trading will occur on thin volumes. Next week, markets will take cues from the November monthly payrolls report, and from the results of “Black Friday” retail spending.

The next Weekly Market Update will be published on Friday, December 5.