Weekly Market Update

As oil prices slide, fears of a global slowdown drive equities lower

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Article Highlights

- Equity markets decline as tumbling oil prices raise anxiety over the global economic outlook.
- U.S. Treasuries benefit from risk aversion, while high-yield corporate bonds stumble.
- Strong consumer spending may lead to an upward revision to 3Q GDP and our 4Q forecast.
- The ECB may enact quantitative easing in January, but we doubt it will be the “silver bullet” the markets expect.
- With Fed tightening expected in mid-2015, equity market volatility is likely.

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Equities

Equity markets worldwide experienced steep losses this past week, with investors expressing concern that the rapid fall in energy prices is not simply the result of rising supply but evidence of a drop in global demand—a sign that economies outside the U.S. are faltering. The S&P 500 Index received a modest boost following a surprisingly strong retail sales report but nonetheless was down about 2.5% for the week.

European equities fared even worse, plummeting more than 6% for the week. In addition to global growth fears, the Greek prime minister’s decision to call for an early presidential election on December 17 spawned worries over political and economic instability in one of the Eurozone’s weakest economies.

In Japan, the yen strengthened as investors flocked to safe-haven assets in the wake of moves to curb risk in China’s debt markets and the potential political unrest in Greece. The Nikkei 225 Index, which recently closed at its highest level in more than seven years, dropped about 3% for the week, but rose on Friday ahead of the country’s December 14 snap elections. Valuations remain attractive, but future equity gains may be limited unless Prime Minister Shinzo Abe’s structural reforms are enacted.

Financial Services

Elsewhere in Asia, China's tighter lending rules drove stock prices down 8% before rebounding. For the year, Chinese equities are up more than 35%, bolstered by effective reforms, expectations of additional central bank stimulus, and increasing retail demand. We believe the substance of the reforms will help stocks in China move higher into 2015.

Fixed Income

U. S. Treasuries rallied strongly amid equity weakness and investor unease. The yield on the 10-year U.S. Treasury, which moves in the opposite direction of its price, began the week at 2.31% but then fell to about 2.10% on December 12. Concerns of global deflationary pressures make U.S. Treasuries look attractive relative to other sovereign bonds, in spite of falling yields. High-yield corporate bonds posted losses, with companies in the energy sector especially hard hit as oil prices dipped below $58 per barrel. Commercial mortgage-backed and asset-backed securities performed relatively well given their general lack of exposure to energy companies.

In European markets, uncertainty over the upcoming elections in Greece pushed yields on 10-year Greek sovereign bonds above 9% in the past week. While Greek bond yields could rise further, we believe the political risks there have already been priced in.

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

Strong consumer spending bodes well for U.S. economic growth

Bolstered by increasingly confident consumers who have benefited from lower gas prices and an improving jobs market, the U.S. economy is on track for 3% GDP growth—or better—in the fourth quarter and could accelerate into the first half of next year.

Recent reports, including those released during the week, provide additional evidence of the economy's positive momentum and spotlight the diverging outlooks between the U.S. and most of the developed world:

- **Retail sales** rose 0.7% in November (0.5% excluding autos), topping forecasts, including our own. Moreover, October's results were revised up from 0.3% to 0.5%, suggesting third-quarter GDP will be revised higher. Further robust consumer spending would prompt us to raise our forecast for fourth-quarter GDP growth, currently at 3.0%.

- **Small business sentiment** hit a seven-year high in November, according to the National Federation of Independent Business. Such strong readings often lead to improved employment growth, higher spending, and increased sales.

- **First-time unemployment claims** ticked down by 3,000, to 294,000.

- **Consumer sentiment** rose to its highest level in almost eight years, as measured by the preliminary December reading of the University of Michigan-Thomson Reuters index.

European QE may be forthcoming, but we remain skeptical of its potential benefits

Speculation continues that the European Central Bank (ECB) will implement full-blown quantitative easing next month. Even if this occurs, we are not convinced that adding more liquidity into the Eurozone economy will solve the region's struggle with deflation and stagnant (or negative) growth. Much-needed economic reforms, especially in Italy and France, have been slow in coming. Additionally, there is little-to-no demand for loans, as evidenced by weak response to the ECB's latest round of low-cost credit offered during the past week. Nevertheless, we view European stocks favorably. Shares are attractively priced, there are some signs of improving economic activity, and any unrest in Greece is not likely to spread.

Outlook

The increased equity market volatility over the past few weeks is likely to continue. Historically, the U.S. stock market corrects four-to-six months before the Federal Reserve begins its interest-rate tightening cycle, which would align with expectations that the Fed's first rate hike will occur around June of 2015. However, such corrections historically have not triggered an outright bear market. In fact, we remain optimistic that a correction could present a buying opportunity. That said, we are mindful of the headwinds created by a stronger dollar and low inflation, each of which could potentially limit revenue growth and earnings estimates for S&P 500 companies.

In fixed-income markets, we believe that most of the oil market's slide has been priced into bond spreads, and solid buying opportunities exist in high-yield corporate and emerging-markets debt. In particular, select B-rated and BB-rated corporate bonds offer good value. Emerging-markets debt should benefit as long as interest rates in the U.S. remain low, since rising rates stateside often lead investors to withdraw capital from the developing world.

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