Weekly Market Update

Volatility continues as U.S. equities end down week on an up note

WILLIAM RIEGEL, CHIEF INVESTMENT OFFICER, TIAA-CREF ASSET MANAGEMENT

Article Highlights

- In another volatile week for stocks, Friday's rebound fails to erase earlier losses.
- Treasury markets extend their rally as investors seek safe-haven assets.
- Switzerland unexpectedly drops its currency cap prior to anticipated ECB quantitative easing.
- Oil prices post a small gain and may be close to bottoming.
- Despite the drop in equity markets, we think the S&P 500 is poised to rebound.

January 16, 2015

Equities

A Friday rally could not salvage the past week for U.S. equities. The S&P 500 fell about 1.2% for the week as investors grappled with mixed economic data, continuing concerns over global growth, and falling commodity prices. Oil rallied more than 5% on January 16 to post a slight gain for the week. We may be nearing the latter stages of the decline in oil prices.

In contrast to the U.S., stocks in Europe rose sharply, due in large part to signs that a significant European Central Bank (ECB) quantitative easing (QE) plan was taking shape. In a surprise, the Swiss National Bank (SNB) decided to abandon its practice of limiting the rise of the franc versus the euro. ECB easing expectations drove the euro to a fresh nine-year low.

For additional TIAA-CREF insights on foreign equity markets from TIAA-CREF portfolio manager Chris Semenuk, view our Weekly Market Perspective Video.

Fixed Income

U.S. Treasuries rallied in a tumultuous week for fixed-income markets. Investors sought the safety of U.S. government securities, with strong demand sending the yield on the bellwether 10-year note down to 1.83% on January 16. (Yields and prices move in opposite directions.)

There were plenty of issues for investors to digest, including concerns over global growth prospects, commodity price declines, the SNB's currency move, upcoming

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elections in Greece, and possible QE in Europe. Bond yields also declined outside the U.S., with record lows recorded in a number of countries, including Germany and Australia. Given the U.S. economy's relative strength, "spread sectors" (especially commercial mortgage-backed securities and investment-grade corporate bonds) appealed to U.S. and foreign investors alike.

Current updates are available here.

U.S. economic data is mixed but in line with our expectations

Despite the surprisingly weak retail sales in December and other mixed economic data released during the week, we still expect fourth-quarter GDP growth of 3%. Trends in job growth are positive, nominal income is rising, and consumer spending should pick up.

Among the week's economic releases:

- **Retail sales** slumped 0.9% in December, a far worse reading than anticipated. Moreover, gains for October and November were revised down.
- **First-time jobless** claims climbed 19,000 to 316,000, and the less-volatile four-week average of new claims rose by 6,750 to 298,000. We are not concerned about these results because seasonal disturbances around the holidays often cause volatility. Monthly job creation should remain above 200,000.
- **Small business confidence** reached a more than eight-year high in December, according to the National Federation of Independent Business.
- **Consumer sentiment** jumped to its highest level since 2004, as measured by January's preliminary reading of the University of Michigan/Thomson Reuters index.
- **Mortgage rates** continued to decline, hitting their lowest level since mid-2013, and mortgage applications picked up significantly.

Wages, which fell in December, are poised to increase in the second half of 2015 as labor markets improve, the unemployment rate keeps declining and more employees are added to payrolls.

Switzerland stuns markets and puts the spotlight on the ECB

On January 15, the SNB announced that it would no longer cap the value of the Swiss franc against the euro, a practice that began during the height of the Eurozone sovereign debt crisis. At the time, surging demand for the franc, considered a safe-haven currency, threatened to hurt Swiss exports and cause disinflation. Markets interpreted the decision as a clear sign that the ECB is prepared to announce QE when it meets on January 22. Swiss bankers fear that without lifting the cap, QE-induced euro weakness will spur demand for the franc, pressuring the SNB's balance sheet.

Outlook

Given recent financial market volatility, low and decelerating inflation, and precariously low growth overseas, many market participants do not believe the Fed will raise interest rates this year. In our view, a 50 basis point rate hike (0.50%) is likely in 2015. Such a move would not hamper economic growth but merely move interest rates off the lower bound. We anticipate more substantial rate hikes will take place no sooner than mid-2016.

The Fed's primary concern is the real economy, and GDP is expanding at a rate of 3% or more. We believe such growth eliminates the need for the Fed's zero-interest-rate policy. Even Consumer Price Index readings of below 1% are not likely to deter the Fed from tightening monetary policy as long as core inflation, which excludes food and energy, remains stable. The key issue for the Fed will be how best to communicate its position.

For U.S. equities, we view the recent market weakness as a temporary phenomenon, with the S&P likely to snap back, perhaps rising above the 2,100 level. Investor sentiment has turned markedly bearish, a signal that historically has been associated with a subsequent rise in stock prices.

In fixed-income markets, we believe that periods of significant volatility can present greater opportunities for security selection than the low-volatility environment of recent years. In particular, select high-yield corporate, emerging-markets, and investment-grade corporate bonds, as well as structured securities, potentially offer value. Treasury yields will remain highly data-dependent, with yields just as likely to rise as they are to fall in coming weeks.

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