Weekly Market Update

U.S. equity markets retreat amid continuing volatility

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Article Highlights

- **U.S. equities decline sharply, while Treasury prices move higher.**
- **European stock and bond markets are mixed, with little evidence of Greek “contagion.”**
- **Fourth-quarter U.S. GDP disappoints, adding to growth concerns.**
- **We expect European equities to outperform U.S. shares this year, with some caveats.**
- **Despite some apprehension about global growth, the Fed is still likely to raise rates in 2015.**

January 30, 2015

Equities

Volatility took a toll on U.S. equity markets during the past week, with the S&P 500 Index ending the week—and the month—in negative territory. Markets were buffeted by slowing U.S. economic data, apprehension over the new Greek government, heightened tensions between Russia and the West, and earnings markdowns for U.S. multinational corporations hurt by the strong U.S. dollar. Oil prices, however, rebounded 8% on January 30 after sinking to a six-year low the day before, supporting our belief that we are likely in the later stages of the oil price decline.

Stocks in Europe were mixed for the week, but rose in the month of January by about 7% in local currency terms, their best one-month showing in more than three years. Most of January’s gain occurred in the days leading up to the European Central Bank’s (ECB’s) announcement of its quantitative easing (QE) program on January 22. The euro’s weakness reduced the month’s return to about 1% in U.S. dollar terms.

Positive earnings revisions helped Japanese shares finish January on an upswing. The Nikkei 225 Index returned about 2.5% in dollar terms for the month. By some estimates, declining oil prices could boost Japanese GDP by 0.7%. Meanwhile, Chinese stocks have hit a turbulent patch after rallying last year.

Financial Services

Fixed income

Treasuries continued their month-long rally, driven by strong demand from central banks, as well as from yield-seeking investors reacting to data showing that Eurozone inflation had fallen to -0.6% in December. The rally pushed the yield on the bellwether 10-year note below 1.7% in afternoon trading on January 30. (Yields and prices move in opposite directions.) Treasuries were also supported by the Federal Reserve's stated intention to remain "patient" as it decides when to begin raising interest rates.

U.S. high-yield and investment-grade corporate bonds outperformed, benefiting from positive fund flows. In Europe, reaction to political uncertainty in Greece was relatively muted in peripheral bond markets, with sovereign debt yields rising only slightly from recent historical lows.

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

Despite challenges, European growth could surprise to the upside

In the wake of the ECB's launch of QE, the eurozone economy should benefit from ongoing currency weakening, a boon to exports. Falling oil prices should also be stimulative. Meanwhile, economic activity seems to be improving as loan growth has accelerated, leading indicators have risen, and sentiment has improved. German business confidence, in particular, picked up in January. Moreover, there have been some tentative moves toward much-needed labor reforms in Italy and France.

Greece's election of a new prime minister, who seeks to end tough austerity measures and renegotiate the terms of the country's bailout package, has added to market uncertainty. Greek stocks fell sharply during the week, although their decline did not spread to the broader European equity markets.

Fourth-quarter GDP growth disappoints

The week's data releases underscored both signs of a slowing economy and areas of strength.

- **GDP** grew at a 2.6% annual pace in the fourth quarter, according to the government's preliminary estimate—below most forecasts, including ours.
- **Durable goods** orders (aircraft, machinery, computer equipment, and other big-ticket items) sank 3.4% in December. Orders in November were revised downward.
- **Consumer confidence**, as measured by The Conference Board Index, soared to its highest level in more than seven years in January, while the Thomson Reuters/University of Michigan consumer sentiment index stood at an 11-year high.
- **First-time jobless claims** fell by a greater-than expected 43,000, to 265,000, touching a 14-year low.

- **New home sales** rose sharply in December, while November purchases were revised downward. **Pending home sales**, though, slipped in December. **Home price appreciation** in November continued to slow, based on the S&P/Case Shiller 20-City Composite Index.

Outlook

Although not cheap, U.S. equities remain attractive relative to bonds. Moreover, both short-term and long-term sentiments are at extremely bearish levels that often signal a market upturn. Volatility will likely accompany any advance, as we believe the Fed—despite some apprehension about slowing global growth—is still planning to raise interest rates this year, a process that historically has led to sharp market movements. While we expect European equities to outperform U.S. shares this year, we are mindful of two key risks: the contentious debt discussions between Greece and its creditors, and the potential for further escalation of hostilities in Ukraine.

A near-term concern in China is that the government may devalue the currency, while the longer-term risk of a so-called economic "hard landing" remains, given plummeting property prices. The real estate sector comprises about 20% of Chinese GDP, approximately the same level reached in Ireland and Spain before their respective housing bubbles burst. In our view, it is likely that the government will tap into its vast resources to help prevent a similar collapse.

In fixed-income markets, Greek sovereign bonds remain under pressure, with the 10-year yield reaching 11% during the past week. We believe contagion to the broader Eurozone is unlikely, although headline risks over the coming weeks could keep yields elevated. Meanwhile, we consider generally low bond yields in the U.S. appropriate, given current disinflationary trends and the overall lack of defaults (except among oil-related high-yield companies). Our interest-rate forecasts will be subject to revision if, as we expect, sustained wage growth begins to take hold.

Financial Services

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