Weekly Market Update

U.S. equities rebound sharply, nearly erasing January's losses

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- U.S. stocks rally and Treasury prices fall amid improved earnings and economic data.
- January's better-than-expected U.S. payrolls report signals an upward shift in job growth.
- In Europe, the economy continues to perk up, and the ECB exerts pressure on Greece.
- The U.S. economy will likely slow in Q1 but accelerate later in the year.
- Although we expect future gains for U.S. and European stocks, near-term pullbacks are possible.

February 6, 2015

Equities

U.S. equities surged 3.4% for the week through February 5, erasing January's losses, but gave back some of those gains the following day. The broad market advance was underpinned largely by positive revisions to earnings estimates, a rebound in commodities prices, and some improving economic data. This environment supported a market rotation back into economically sensitive sectors such as Energy, Materials, and Consumer Cyclicals.

European indexes also moved steadily higher, lifted in part by a strong U.S. jobs report, although Greek stocks fluctuated wildly as hopes for a favorable resolution to the impasse with the European Central Bank (ECB) waxed and waned. Meanwhile, Chinese shares continued to struggle. This may reflect the extended nature of the market's advance last year, in addition to the economy's slowdown. During the week, China's central bank lowered reserve requirements for banks, a measure designed to stimulate bank lending.

Fixed income

The month-long U.S. Treasury rally stalled, amid stabilizing oil prices and the robust payrolls report. The yield on the 10-year Treasury climbed throughout the week, closing at 1.96% on February 6. (Yields and prices move in opposite directions.) Among non-Treasury securities, high-yield corporate bonds performed well, supported by positive fund flows and limited new issuance.

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European fixed-income markets continued to benefit ahead of the ECB's open-ended quantitative easing program, which begins in March. Moreover, concerns over renegotiating the terms of Greece's bailout did not spread to other peripheral bond markets.

Current updates are available here. For additional insights from TIAA-CREF investment professionals, view our Weekly Market Perspective Video.

January payrolls indicate an upward shift in U.S. job growth

The U.S. economy added a higher-than-expected 257,000 jobs in January. Additionally, October and November payrolls were revised upward by a combined 147,000. These positive revisions are common during the upward portion of the business cycle because the government tends to underestimate turning points. Payrolls have now increased by an average of 336,000 over the past three months, the best quarterly stretch since 1997.

Meanwhile, the unemployment rate inched up to 5.7%, as roughly 700,000 people entered the workforce, the most in seven years. Wage growth also jumped 0.5% in January, putting the 12-month increase at 2.2%, close to a post-recession high. Broadly speaking, we believe two more reports with similar gains would confirm the trend of materially stronger labor markets.

Other data releases for the week highlight further expansion of consumer activity, although tempered by some signs of weakness on the industrial side.

- **Personal income** rose 0.3% in December. **Consumer spending,** in contrast, dropped 0.3%.
- **Automobile sales** surged in January, normally a slow month.
- **Service-sector activity** edged up to 56.7 in January, based on the non-manufacturing index published by the Institute for Supply Management (ISM).
- **Manufacturing activity** downshifted in January, with the ISM's Purchasing Managers Index (PMI) registering 53.5. The index remained above the 50 level separating expansion from contraction but is creeping in that direction. A similar manufacturing index from Markit stayed at 53.9 in January.
- **Factory orders** fell 3.4% in December for the fifth straight month.
- **Net exports** slipped in December, contributing to the largest trade deficit in two years.

The ECB plays hardball with Greece's anti-austerity government

While Europe has been closely watching the tense exchanges between the ECB and Greece, its equity markets have so far been unaffected. It's not clear that will remain the case given the ECB's February 4 announcement that it would no longer allow Greek banks to use Greek sovereign bonds, which are below investment-grade, as collateral for cheap loans. Ultimately, we believe negotiations will arrive at some middle ground, but there's still a risk that the Greek government will pursue the country's exit from the eurozone.

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Outlook

While U.S. job growth is progressing well, the week's other economic reports were mixed. This does not signal a weakening of the U.S. economy. Instead, the industrial side's output is currently not "in synch" with improving consumer incomes and spending. Against this backdrop, we expect first-quarter GDP growth in the 2.5% range. As the two sides eventually mesh, the U.S. economy should pick up speed in the second quarter.

In Europe, economic conditions are improving. PMIs, factory orders, and consumption are all on the upswing. While it's too early in the year to determine whether this better data is simply a first-quarter phenomenon, we would not be surprised if the region's GDP expands by 2% in 2015. For now, though, we are keeping our forecast of 1% growth.

The course of Greece's negotiations with the ECB could lead to a pause for European equities, which we expect to perform well overall this year. We are mindful, though, that almost 80% of European stocks are trading above their 50-day moving averages, an indicator that often foreshadows a pullback. In the U.S., we still believe the S&P 500 Index can move higher in 2015, although accompanied by continued volatility.

For fixed-income investors, rising wage growth may help reduce concerns about disinflation in the U.S. and provide an impetus for the Federal Reserve to begin raising rates beginning at mid-year, as we expect it will. In our view, higher rates would buoy markets domestically and globally, as they would presage an eventual return—albeit a slow one—to a normalized rate environment. We continue to find good value in investment-grade and high-yield corporate bonds, except for the highly leveraged, lowest-rated issues.