Weekly Market Update

Equities rally on news of a Greek debt deal

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- Eurozone officials and Greece agree on a four-month extension of the country's bailout.
- U.S. equities close at a record high but may be nearing overbought levels.
- Economic activity continues to pick up in Europe.
- Recent Treasury rate movements suggest the bond market expects the Fed to tighten sooner rather than later.
- U.S. economic data releases are softer, but we expect growth to accelerate.

February 20, 2015

Equities

A week of on-again, off-again progress in the Greek debt standoff culminated in a Friday afternoon announcement that Greece and its creditors had agreed to a four-month extension of the country's bailout. News of the deal sparked a week-ending rally that saw the S&P 500 Index close at 2,100, a new record high. While the accord was announced after European equity markets closed, stocks in Europe had already risen to a seven-year high during the week on expectations that a deal would ultimately be reached. The euro also received a boost.

Earlier in the week, U.S. equities had been supported by strong mergers and acquisitions activity, improving inflation expectations, and a perceived "dovish" tilt in minutes from the Federal Reserve's January meeting (released February 18).

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

Fixed income

It was a somewhat volatile week for the 10-year U.S. Treasury yield, which alternately spiked to a five-week high on expectations that the Fed's January meeting minutes would point to a mid-year tightening, then fell when those minutes suggested that the Fed was not in a rush to raise interest rates. The yield began to climb again in the wake of the Greek debt agreement. Reduced

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concerns about a potential Greek exit from the eurozone provided a stable backdrop for other sovereign bond markets, including Spain and Italy.

Among spread products (higher-yielding, lower-rated, non-U.S. Treasuries), positive fund flows continued to support high-yield corporate bond performance, while returns for investment-grade debt were negative. Demand for high-yielding fixed-income assets is strong, as the supply of government bonds has dwindled amid global quantitative easing programs.

The U.S. economy is running in place

This week's data releases showed a U.S. economy that has neither accelerated nor decelerated since December. However, we still expect growth to perk up toward the end of the first quarter.

- **First-time unemployment claims** fell 21,000 to 283,000, while the less-volatile four-week moving average also declined, to 283,250. Both figures signal that the pace of hiring remains strong.
- **U.S. manufacturing**, as measured by the Markit “flash” (preliminary) Purchasing Managers Index (PMI), rose slightly in February to 54.3. While above the 50 level separating expansion from contraction, the reading confirms a relatively modest pace of activity.
- **U.S. regional manufacturing indexes,** meanwhile, slowed in February, according to the Empire State and Philly Fed survey readings.
- The index of **leading economic indicators** published by The Conference Board inched up in January, pointing to a positive short-term outlook.
- **U.S. housing starts** and **building permits** dipped in January, and **homebuilder confidence** ticked lower in February, based on the NAHB/Wells Fargo index.

These soft housing releases may be the result of January’s severe weather, in which case we expect an even steeper decline in February’s data. More likely, the weakness can be attributed to the broader economic slowdown that began in December. In spite of its sluggish start to 2015, the housing sectors should recover, and we still expect home prices to appreciate by 3% to 5% this year.

Economic growth in Europe continues to improve

On the heels of data releases spotlighting better-than-expected fourth-quarter GDP growth in Germany and the Eurozone, the flash reading of Markit’s PMI for the region showed manufacturing and service-sector activity accelerating in February to 51.1 and 53.9, respectively. Adding to the positive news was stronger job creation, which reached its highest level since August 2011.

Outlook

While Fed officials may have sounded a cautious note on raising interest rates, the minutes were drafted before January’s strong jobs report was released on February 6. This information may change the Fed’s thinking about when to begin tightening.

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Fed Chair Janet Yellen’s Congressional testimony on February 24 and the press release that will be issued after the Fed’s March meeting should provide some clarity on the central bank’s next move.

For U.S. equities, a near-term pullback would not surprise us, as the S&P 500’s rise has brought the index close to overbought levels. Nearly 80% of U.S. equities are trading at their 50-day moving average, a level that often precedes a correction.

Interest-rate movements since February 1 suggest that the bond market anticipates a rate hike sooner rather than later. Yields on the 2-year Treasury (which is most sensitive to expectations about the Fed's rate policy outlook) and the 5-year note have firmed. In the past, a steep rise in the 2-year yield relative to the 5-year has been closely associated with an imminent (one to two months) rise in the federal funds rate.

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