Weekly Market Update

Global equity markets decline on Greece and China worries

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- Heightened fears of a Greek debt default and new stock-market rules in China drive stock markets lower.
- We believe an agreement will eventually be reached to avoid a “Grexit” from the euro.
- U.S. Treasury prices rise on mixed economic data, but liquidity and trading volume are light.
- ECB quantitative easing and demand for safe-haven assets push German bond yields near zero.
- We are encouraged by signs of a pick-up in U.S. retail sales and housing activity.

April 17, 2015

Equities

After moving marginally higher for most of the past week, U.S. equities fell sharply on April 17, with the S&P 500 Index down about 1.4% in afternoon trading. Heightened fears of a potential Greek debt default, along with China’s announcement of revised short-selling and margin lending rules for its stock markets, drove the Friday sell-off. Earlier in the week, rising U.S. stocks had been led by consumer cyclicals and value shares, both of which tend to perform well in a strengthening economy.

European stocks hit a new record high at midweek but then gave back gains to post a loss for the week, as apprehension about Greece and further tensions in Ukraine soured the mood. The rally in China continued despite news that Chinese GDP growth had cooled to 7% in the first quarter, the slowest rate of expansion since 2009. Meanwhile, China’s newly announced market regulations may put the brakes on what has been a sustained run-up in Chinese equity prices this year.

Financial Services

Fixed income

U.S. Treasury prices rose moderately on light trading volume in response to the week's generally softer-than-expected U.S. data reports and suggestions by Federal Reserve officials that there is no rush to raise interest rates. After starting the week at 1.96%, the yield on the bellwether 10-year note closed at 1.87% on April 17. (Price and yield move in opposite directions.) Returns for "spread products" (higher-yielding, lower-rated non-U.S. Treasury securities) were broadly positive for the week through April 16. Fund flows into most fixed-income sectors were muted, although prices firmed a bit for both high-yield and emerging-markets debt.

Overseas, German bond prices climbed as Greece's debt problems fueled renewed strong demand for safe-haven assets. Quantitative easing (QE) asset purchases by the European Central Bank (ECB) also played a role in driving the yield on 10-year German bonds to a record-low 0.08%.

Current updates are available here. For additional fixed-income insights from Lisa Black, Chief Investment Officer of the TIAA General Account, view our Weekly Market Perspective Video.

Despite mixed data releases, we expect the U.S. economy to begin picking up

We see enough bright spots in this week's large batch of U.S. economic data to remain confident that growth will accelerate into the second quarter. Housing, in particular, is strengthening after a rough winter, and expectations for higher interest rates should prompt undecided buyers to enter the market before rates go up. Among the week's better reports:

- **Housing starts** rebounded in March, and **homebuilder confidence** rose in April.
- **Consumer sentiment** reached its second-highest level in more than eight years, according to a preliminary reading of the Thomson Reuters-University of Michigan index. Consumers were more upbeat about the economy, their finances, and future spending.
- **Leading economic indicators** rose in March, according to The Conference Board.
- **Retail sales** grew 0.9% in March (+0.4% excluding autos)—an improvement over recent months, but still weaker than expected.

Among the weaker releases:

- **First-time unemployment claims** climbed to 294,000, and the less-volatile four-week moving average inched up to 282,750, but both remained well below the key 300,000 level.

- **Regional manufacturing indexes** were mixed, as the Philly Fed showed mild improvement, while the Empire State Index unexpectedly dropped sharply.
- **Small-business optimism** dipped in March, according to the National Federation of Independent Businesses.

As Eurozone economic improvement continues, another deadline approaches for Greece

This week brought additional evidence of the Eurozone's recovery. Eurozone auto sales increased in March, and industrial production topped forecasts. Deflation fears ebbed as well. Eurozone consumer prices rose 1.1% in March for the second month in a row, data that will be welcomed by the ECB as it monitors the effects of QE. On a year-over-year basis, inflation, while still negative in March (-0.1%), firmed compared to February's reading (-0.3%).

Meanwhile, concerns are mounting that Greece will be unable to reach an April 24 deadline for an agreement with its international creditors. Although the country made a substantial debt payment to the International Monetary Fund (IMF) earlier this month, it owes more than €2.5 billion ($2.7 billion) to the IMF in May and June, along with expenses for government wages and pensions.

Outlook

For the S&P 500, we continue to eye a near-term target level of 2,150 to 2,200. A correction is possible at that level, most likely triggered by the beginning of Fed tightening. Equity markets tend to become much more volatile as tightening begins, correcting about four months in advance of the Fed's initial move. After a weaker-than expected first quarter for the U.S. economy, the first interest-rate hike is now more likely to occur in September.

Although stocks in Europe fell this week, we believe they offer attractive expected returns, especially compared to U.S. stocks. Despite overly optimistic investor sentiment in Europe and rising fears of a Greek exit from the Eurozone, the signs of a Eurozone recovery continue apace, earnings revisions have turned positive, and corporate earnings growth potential is high.

We believe an agreement will eventually be reached to avoid a "Grexit." If Greece were to leave the currency bloc, we believe the Eurozone could withstand its departure—Greece's economy is half the size of Houston's— but such a move would be disruptive and stir up volatility in equity markets and riskier sectors of the bond market.

In fixed income, we continue to believe that fixed-income spreads are reasonably priced given a low risk of defaults and our expectations for moderate rate increases by the Fed. On balance, U.S. bonds and equities currently offer similar value. In the Eurozone, however, equities are more attractively valued in light of the extended fixed-income rally there.

Financial Services

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