Weekly Market Update

Earnings, M&A activity, and a brightening economic outlook drive U.S. stock rally

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

Article Highlights

- Both the S&P 500 and the NASDAQ close at new record highs.
- Demand for U.S. Treasuries weakens amid mixed U.S. economic reports, higher stock prices.
- Although the ECB is well ahead of its bond-buying target, we see no let-up in the pace of QE.
- Greece and its creditors are in another negotiating phase, with an agreement likely in June.
- The U.S. economy fared worse than expected in Q1 but appears poised to rebound.

April 24, 2015

Equities

U.S. equities closed at their best levels since early March. The S&P 500 Index briefly eclipsed its all-time intraday high and ended the week at a new record close of 2,118. Consumer cyclical stocks, a bellwether for a strengthening economy, continued to lead the way. Technology shares in particular have outperformed, evidenced by a new record close for the NASDAQ as well. The recent equity rally has been underpinned by a revival in share buybacks and mergers & acquisitions, the relative attractiveness of stocks versus bonds, and first-quarter corporate earnings, which, while far from stellar, have generally come in better than expected.

Stocks in Europe moved slightly higher for the week. Positive economic news out of Germany outweighed other disappointing data releases, mixed earnings reports, and worries over the Greek debt saga.

Fixed income

Uneven U.S. economic reports, marginally constructive discussions between Greece and its creditors, and strong equity gains eased demand for U.S. Treasuries (especially longer-dated bonds), lowering their prices and boosting

TIAA CREF
Financial Services

their yields. (Price and yield move in opposite directions.) The yield on the 10-year note, which began the week at 1.87%, hovered around 1.92% on April 24.

Asset flows into fixed-income funds were muted, except for investment-grade corporate bonds. New issuance is being readily absorbed by the market as significant demand continues for the high-quality debt needed by insurers, money managers, pensions, and central banks. Market sentiment has lately been less focused on rhetoric about the exact timing of a Federal Reserve interest-rate hike, instead taking cues from economic releases. Spreads for higher-yielding, non-U.S. Treasury sectors may widen if economic releases strengthen, potentially signaling a faster pace of rate increases by the Fed.

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

Housing stands out in a week of mixed U.S. data

This week's economic releases provide further evidence that activity bottomed in March and is now picking up. Heading into the second quarter, we expect housing, along with continued jobs growth and a likely boost in wages, to drive the recovery. Among the week's reports:

- **First-time unemployment claims** ticked up by 1,000, to 295,000, and the less-volatile four-week moving average also moved marginally higher, to 284,500.
- **U.S. manufacturing activity** fell to 54.2 in April, as measured by the Markit "flash" (preliminary) Purchasing Managers' Index (PMI), but remained well above the 50 mark separating expansion from contraction.
- **New home sales** dropped 11.4% in March but surged 19.4% compared to a year ago, while February's seven-year high was revised even higher. Meanwhile, **existing home sales** climbed 6.1% in March, the fastest pace in 18 months.
- **Home prices rose slightly in February versus January and** were up 5.4% compared to a year ago, according to the FHFA.
- **Mortgage applications** maintained their sharp rise since February, reflecting more robust housing demand and consumers' ability to assume more debt—both of which feed directly into the broader economy. Additionally, banks have shown increased willingness to lend.
- **Durable goods orders** (aircraft, machinery, computer equipment, and other big-ticket items) jumped in March, but the increase was driven almost entirely by higher demand for autos, commercial jets, and military hardware.

No let-up expected in QE monetary easing by the ECB

A raft of recent economic releases has signaled stronger growth in the Eurozone, as the region has benefited from the quantitative easing (QE) program initiated by the European Central Bank (ECB) on March 9. Since then, the ECB's balance sheet has grown by €210 billion, putting the central bank on a pace to reach its €1 trillion expansion goal before the end of 2015, well ahead of its September 2016 target. We expect the ECB to keep its foot on the liquidity pedal until at least the fall of next year.

Outlook

Since the U.S. recovery began, the first quarter of each year has been sluggish; this one will be prove to be no different. We expected a weak January and February, but the rebound we anticipated for March failed to materialize. Therefore, we are lowering our first-quarter GDP estimate again, from 1.5% to 1.0%. We expect the government's initial first-quarter GDP estimate to come in at +1%, with subsequent downward revisions likely. Markets may respond unfavorably, but it's important to remember that the first quarter's significant headwinds were mostly transitory. The soft first quarter has also prompted us to lower our overall 2015 GDP forecast, from 3.0% to 2.7%, but we take heart in that recent market movements have been led by more cyclical sectors.

Also on the economic front, we remain puzzled by the inability of lower gas prices to jumpstart U.S. consumer spending. While this could simply mean that consumers are saving the windfall until their sentiment improves, recent gains in consumer confidence measures may indicate a secular change in spending habits as the U.S. population ages. We should have a clearer picture by mid-year.

In U.S. equity markets, contrarian indicators point to a continued advance for the S&P 500. Long-term sentiment remains negative, Wall Street strategists are still underweighting equities, hedge fund net exposures are only slightly above 50, and—for the first time in over a decade—corporate pension funds hold more bonds than stocks. For the fixed-income markets, we believe current Treasury yields and broad fixed-income spreads broadly are fairly priced.

Regarding Greece, domestic public approval of the government's negotiating tactics has fallen from 76% to 46%, while a desire to remain within the Eurozone remains high. In our view, the odds of a "Grexit" have risen somewhat but remain at about 30% or less. It appears that Greece should be able to meet an upcoming €750 million payment to the International Monetary Fund, but unlocking bailout funds to fulfill additional obligations, will require Athens to reach an agreement with its international creditors or face the prospect of default. We think this uncertainty will likely continue through June but believe that a rational outcome will ultimately prevail.

TIAA CREF Financial Services