Weekly Market Update

Global equity markets falter as Greek uncertainty persists

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Article Highlights

- Greek gridlock sends U.S. stocks lower and trims gains in Europe.
- U.S. Treasury prices fall amid strong economic data, highlighted by housing and consumer spending.
- The U.S. economy contracted 0.2% in Q1, less than previously reported.
- The Eurozone's economic recovery continues despite Greek uncertainty.
- In our view, continued volatility should be expected in both equity and fixed-income markets.

June 26, 2015

Equities

Global equities waxed and waned during the past week, as hopes for a resolution to the Greek debt crisis gave way to disappointment when negotiations stalled late in the week. The S&P 500 Index lost about 0.5% for the week, while European stocks rose. Overall, though, markets seem to be taking the Greek talks in stride, with fears of a "Grexit" giving way to headline fatigue.

In spite of a report showing that Japan's manufacturing sector contracted in June, the Nikkei 225 Index rose almost 2.0%, hitting a more than 18-year high along the way. Although the yen has weakened versus the U.S. dollar this year, the Nikkei is up 15.1% year to date through June 26 in dollar terms. Japan's advance has been supported by the government's continued push for corporate governance reform.

The risk of an economic "hard landing" in China remains, even as its economy appears to be bottoming. Housing demand has picked up and the manufacturing sector, while contracting in June, has stabilized. Meanwhile, Chinese stocks—which have led global equity markets this year—plunged in the past week, with major indexes down about 20% from recent peaks, nearing bear market territory.

Fixed income

Solid U.S. economic reports pushed 10- and 30-year Treasury yields higher, while brief bouts of optimism around a Greek aid package dented demand for safe-

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haven assets. After beginning the week at 2.26%, the bellwether 10-year Treasury spiked to 2.48% on June 26.

Rising rates also hurt performance of U.S. spread products (higher-yielding, non-U.S. Treasury securities). Investment-grade bonds were especially hard hit amid continued outflows. In addition, liquidity became scarce as the quarter drew to a close, and the possibility of a near-term Fed rate hike fanned concerns for both broker-dealers and large asset managers about adding to their positions.

Yields on Eurozone sovereign debt remained well above the lows induced by the European Central Bank's quantitative easing program, reflecting the region's continued positive economic releases.

Current updates are available here.

For additional investment insights from TIAA-CREF Portfolio Manager Anupam Damani on the Greek crisis, view our Weekly Market Perspective Video.

Another good week for U.S. economic data

With housing activity and consumer spending reaching multi-year highs, and the U.S. jobs market showing continued vigor, the week's data releases were mostly positive. Among the reports:

- **First-time unemployment claims** edged up to 271,000, and the less-volatile four-week moving average dipped to 273,750. Both levels are consistent with an improving employment outlook.
- **Existing home sales** rebounded from April's decline by rising 5.1% in May, their fastest pace since November 2009, and were up 9.2% compared to a year ago. **New home sales** increased by 2.2% to a more than seven-year high and surged 19.5% compared to last year. April's totals for both categories were revised upward.
- **Consumer spending** jumped 0.9% in May, the biggest gain in six years, while spending for both March and April was revised upward.
- **Consumer sentiment** beat expectations by hitting its highest level of the year, according to final June reading of the University of Michigan index.
- **U.S. manufacturing** slowed to 53.4 in June, according to Markit's "flash" (preliminary) Purchasing Managers' Index (PMI), but remained above the 50 mark separating expansion from contraction.
- **U.S. service-sector activity** also eased in June, with the "flash" PMI dipping to 54.8.
- Although the headline figure for **durable goods orders** (aircraft, machinery, computer equipment, and other big-ticket items) fell by a greater-than-expected 1.8% in May, orders rose 0.5% excluding the volatile transportation sector. Business investment rebounded, as orders for core capital goods ticked up 0.4%.

Meanwhile, according to the government's third and final estimate of first-quarter GDP growth, the U.S. economy shrank at a 0.2% annual rate in the first three months of the year, an improvement over the previous estimate of a 0.7% decline.

The European economy shrugs off the Greek drama

The past week brought additional evidence of the Eurozone's recovery. The region's manufacturing and service-sector activity improved in June to a four-year high of 54.1, according to Markit's "flash" Eurozone PMI. The upturn was broad-based, with strong gains in employment and new orders. France, a latecomer to the recovery, notched its best month since August 2011. Additionally, the Citi Economic Surprise Index for Europe has been moving higher. This index is a gauge of the extent to which economic data releases have diverged from consensus forecasts.

Outlook

On balance, U.S. stocks continue to be supported by a dovish Fed, who has made it clear that the pace of rate increases will be gradual regardless of the liftoff date.This measured approach could help contain long-term yields, making stocks relatively more attractive than bonds. On a cautionary note, past Fed tightening has introduced heightened market volatility. So while we maintain our year-end S&P 500 target of 2,300, the advance will likely be uneven.

European equity markets may soon get a reprieve from Greek uncertainty. Expectations are for an agreement to be reached without the disruptive effects of capital controls on Greece's banking system. If the negotiations drag on, however, the fallout could trigger corrections that we would view as potential buying opportunities. Eurozone stocks, while not cheap, offer upside potential given their currently low profit margins, which are 20%-25% below normal. Meanwhile, improving Eurozone growth, coupled with a relatively dovish Fed, will weaken the dollar and strengthen the euro, creating a tailwind for U.S. investors.

We also expect continued volatility in fixed-income markets until the first Fed rate hike is announced and digested by investors. At that point, non-Treasury sectors could rally, underpinned by the Fed's expected slow pace of rate increases and reasonable levels of fundamental risks (such as defaults).

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