Weekly Market Update

Investors cheer renewed hopes of a Greek deal, though uncertainty remains

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

- A new proposal provides grounds for further Greek talks, and we believe the odds favor a deal being reached.
- Greece-fueled optimism trims losses for U.S. stocks and erases a decline in Europe.
- U.S. Treasury yields are volatile as risk appetite fades, then picks up.
- The Chinese government steps in to halt a sharp selloff in domestic equities as investor anxiety persists.
- In our view, the slide in Chinese stocks is unlikely to spill over to the broader economy.

July 10, 2015

The Greek debt crisis take a hopeful turn—for now

Faced with a June 12 deadline to reach a bailout agreement or face a possible exit from the Eurozone, the Greek government has submitted a proposal that, as of this writing, appears to be substantive enough for talks to continue. This does not mean a deal will be reached immediately, although it is possible that a “bridge” package will be arranged to keep the Greek economy afloat. Negotiations could then restart with a goal of reaching an agreement prior to July 20, when Greece is scheduled to repay €3.5 billion euros ($3.9 billion) to the European Central Bank (ECB).

Equities

Global equities endured a fresh wave of volatility during the past week, fueled by ongoing anxiety over Greece and a dramatic selloff in China. After falling early in the week, markets changed course, as hopes for a Greek bailout deal were rekindled and massive intervention by the Chinese government propped up that country’s markets.

In the U.S., despite headlines proclaiming a stock market “correction,“ the S&P 500 Index pared earlier losses to finish effectively unchanged for the week, holding firm at key technical levels and never dropping more than 4% below its late-June peak. Meanwhile, the STOXX Europe 600 Index rose 1.1% for the week after falling to a five-month low on July 7. Year to date through July 9, this index

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has outpaced the S&P 500 by 3.5% to 0.7%. In our view, European stocks remain more attractive than U.S. shares.

Chinese equities ended the week with two days of gains, as Beijing's near-daily moves halted a slide that saw major domestic indexes plummet more than 20% from June's highs. Among other measures, the government has cracked down on short sellers, eased margin requirements to encourage stock purchases, and suspended trading in several markets.

Fixed income

U.S. Treasuries were volatile amid the week's uncertainty. Increased demand for safe-haven assets drove the yield on the bellwether 10-year note down from 2.40% to 2.22% on July 8 before investors' renewed risk appetites pushed it back up to 2.41% as of afternoon trading on July 10. (Yield and price move in opposite direction.) With Greece-related fears easing—at least for now—investors will look to the Fed and upcoming economic releases for guidance on the direction of interest rates.

Yields on German government bonds—also a typical haven in volatile times—rose during the week. In contrast, sovereign yields from peripheral Eurozone markets such as Italy and Spain declined, a sign that investors believe these countries are on better financial footing than in the past, and thus prepared to handle any fallout from a potential Greek default, and that the ECB has the tools at its disposal to address any financial problems.

Growing optimism on the geopolitical front supported most U.S. "spread" products (higher-yielding, non-U.S. Treasury securities), including emerging-market debt, investment-grade corporate bonds, and commercial mortgage-backed securities. High-yield corporate bonds lost ground, however, as renewed worries about oil-linked corporates triggered outflows.

Current updates are available here.

For additional market insights from TIAA-CREF Global Investment Strategist Dan Morris, view our Weekly Market Perspective Video and read the 2015 mid-year outlook by Dan and TIAA-CREF Chief Economist Tim Hopper.

Outlook

While we have long believed that an agreement will ultimately be reached in Greece, we have also remained confident that the risk of "contagion" is low if Greece were to leave the Eurozone. First, the country's economy is very small—about the size of Oregon's. More importantly, Greece relies heavily on imports and leans on tourism to pay for those goods. Lastly, the economy is predominantly cash-based, with little manufacturing activity. In short, with Greece's limited role in the regional and global economies, the potential for broader economic impact from a "Grexit" is minimal.

It is also worth noting that the pain being endured by Greece may discourage other anti-austerity political parties in Europe from seeking more attractive bailout terms. Longer term, there are hopes for further fiscal integration within the Eurozone to go along with monetary union, which could help avert Greek-like scenarios In the future.

Investors cheer renewed hopes of a Greek deal

Although Greece dominated the headlines, the sharp drop in Chinese equities, and the government's intervention, is a greater concern. Ironically, Beijing's actions may further stoke investor anxiety rather than quell it. Moreover, the government's recent moves threaten to undermine financial market reforms that have already been enacted.

It is unlikely though, that declining share prices will dampen Chinese consumer spending or reveal structural weaknesses in its economy. This is because Chinese companies don't use equity markets to raise capital as American corporations do. Additionally, whereas wealth generation in the U.S. is closely tied to stock market returns and home price appreciation, many Chinese retail investors generally own only small equity portfolios. Their wealth tends to be concentrated in bank deposits, and, in some cases, real estate.

For U.S. equities, we believe the S&P 500 will rise from current oversold levels and reach our target of 2,300 by year-end. The proportion of S&P 500 stocks trading below their 50-day moving average recently reached 80%, historically a reliable indicator of a subsequent market rebound. In U.S. fixed-income markets, investment-grade corporate bonds continue to lag amid supply pressures, a situation that should reverse slightly in the second half of the year. Overall, U.S. debt looks fairly valued compared to stocks.

In terms of the U.S. economy, we believe the second quarter will be modestly better than the first, with GDP growth of about 2.3%, a bit below other forecasts. There are signs that consumer spending is picking up as wages start to lift, which could pave the way for more robust growth during the second half of the year.