Weekly Market Update

Equity markets retreat in an unsettled week

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- Weak corporate earnings and September rate-hike fears drive the S&P 500 Index lower.
- U.S. Treasury performance also wavers amid mixed economic data and conflicting “Fedspeak.”
- We believe July’s employment report could support a case for either a September or December Fed rate hike.
- Eurozone stocks are marginally higher for the week, while emerging markets continue to struggle.
- Bond-market liquidity remains a concern even as it may lead to buying opportunities.

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Equities

After providing a tailwind for U.S. stocks over the previous few weeks, corporate earnings shifted to a headwind, with disappointing releases from the Media and Energy sectors in particular hurting performance. The S&P 500 Index fell for most of the week and was down about 1.4% through afternoon trading on August 7.

In Europe, equities continued their rally following the Greek debt agreement, again lifted by one of the strongest corporate earnings seasons since 2009. Despite severe volatility in Greek stocks, which resumed trading following a five-week closure of the Athens Stock Exchange, the STOXX 600 Index eked out a 0.2% gain for the week. In contrast, emerging-market stocks endured yet another difficult week. A combination of falling commodity prices, local currencies approaching 15-year lows versus the U.S. dollar, dismal investor sentiment, and profit margins that are below those of developed markets have all weighed on the broad MSCI Emerging Markets Index, which has declined about 6% year to date in U.S. dollar terms.

Fixed income

Markets were confronted with a mixed bag of economic data, further weakness in oil and commodity prices, and conflicting commentary from Federal Reserve officials, which intensified the debate over the timing of the Fed’s next rate hike. Against this muddled backdrop, the bellwether 10-year U.S. Treasury yield, which

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began the week at 2.20%, headed higher by midweek but dropped to 2.18% during afternoon trading on August 7. (Price and yield move in opposite directions.)

The yield on the 2-year note, which is highly sensitive to changes in the outlook for Fed policy, traded as high as 0.76% on August 7, its highest level for the year. Meanwhile, a risk-averse atmosphere led to reduced demand for U.S. “spread” sectors (higher-yielding, non-U.S. Treasury securities). Investment-grade and high-yield corporate bonds, along with emerging-market debt, were especially hard hit.

Current updates are available here. For additional insights from TIAA-CREF Chief Economist Tim Hopper, view our Weekly Market Perspective Video.

U.S. data releases are mixed to positive

Most of the week’s economic releases support a slight upward revision to second-quarter GDP growth but also point to a slow beginning to the third quarter. Monthly payroll gains for July came in at 215,000, a middle-of-the-road reading, while May and June payrolls were revised upward by a combined 14,000. Both the unemployment rate (5.3%) and the labor force participation rate (62.6%) remained unchanged.

July’s employment numbers could support a case for either a September or December rate hike by the Fed. Those who believe a September “liftoff” is in the cards will focus on tightening labor markets, while those leaning toward December can point to only moderately higher wages in July (+2.1% year-over-year growth). Although we believe the earlier option is justified, in our view the odds are evenly split between the two, as the Fed has yet to clearly signal its intentions.

Other economic reports were mixed to generally positive. Among the highlights:

- **First-time unemployment claims** edged up to 270,000, hovering near their lowest level in decades, and the less-volatile four-week moving average fell to 268,250.
- **Consumer spending** rose a modest 0.2% in June. May spending was revised downward, to 0.7%.
- **Mortgage applications** jumped, spurred by lower interest rates.
- **The U.S. trade deficit** widened 7.1% in June, to $43.8 billion, up from a revised $40.9 billion in May, as the strong dollar boosted imports and hurt exports. Weakening global demand also weighed on exports.
- **U.S. service-sector activity** surged to 60.3 in July, a 10-year high and well above the 50 mark separating expansion from contraction, according to the non-manufacturing index published by the Institute for Supply Management (ISM). A similar index from Markit also expanded, to 55.7 in July.
- **U.S. manufacturing** softened to 52.7 in July, based on ISM’s Purchasing Managers’ Index (PMI).
- The **Citi Economic Surprise Index** rose for the second consecutive month in July. This index is a gauge of the extent to which U.S. economic data releases have diverged from consensus forecasts.

Outlook

We remain positive on European stocks, as corporate earnings prospects look solid. In addition, there are reasons to be more sanguine about emerging-markets equities, despite their recent underperformance. Bank lending conditions in the various regions appear to have eased slightly, and signs of a potential economic bottoming in China have emerged. These include improving manufacturing gauges in Korea and Taiwan—two countries heavily dependent on the Chinese economy—and a sharp rise in China's service-sector activity in July. A stronger China should lead to a pickup in commodity demand in the second half of the year and, by extension, better economic and equity performance in the developing world.

In fixed-income markets, we believe the current "risk-off" climate will continue until the Fed's tightening cycle begins or clearer guidance emerges, at which time some recovery in spread sectors is possible. Although shifts in investor sentiment related to the Fed's next move could present challenges, we expect corporate defaults to stay low in coming months (with the possible exception of oil and gas companies) and wage growth to remain in check, creating a mostly positive environment for bonds. However, tight liquidity in the bond market remains an issue that is not likely to fully manifest until there is an equity market correction or heightened geopolitical and global economic worries. While such developments could pressure spreads significantly, they could also present buying opportunities.