



# Global equities retreat on growth, currency devaluation concerns

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

- U.S. stocks turn negative year to date, while European shares enter correction territory.
- Treasuries rally as investors seek safe-haven assets.
- Housing data hits a series of multi-year highs in a week of mixed economic data.
- We expect U.S. GDP to be revised higher in Q2 before easing in Q3.
- In our view, China's vigorous defense of the yuan in the past week should defuse fears of a currency war.

**August 21, 2015**

### Equities

Worries over a slowing Chinese economy, falling commodity prices, and weakening emerging-markets currencies in the wake of China's recent devaluation dragged down global equities during the past week. Adding to the uncertainty was the release of minutes from the Federal Reserve's July meeting, which markets perceived as dovish even though the Fed did not provide clarity on the timing of rate "liftoff."

The S&P 500's nearly 6% decline for the week erased all of 2015's year-to-date gains and saw the index finish below the 2,000 level for the first time since February.

In overseas markets, the STOXX Europe 600 Index lost 4.73% in U.S. dollar terms, its worst week in four years, and has now fallen about 13% in local terms from its all-time high reached in mid-April—technically entering correction territory. Contributing to this decline was data showing that manufacturing activity in China, Europe's second-largest trading partner after the U.S., shrank in August at its fastest pace since 2009. This fanned fears that a slump in the world's second-largest economy could derail Europe's recovery. Welcome economic news did arrive as the week ended, with European manufacturing and service sectors expanding robustly in August, bolstered by gains in exports, employment, and wages.

Despite ongoing intervention from Beijing to prop up domestic equity prices, Chinese stocks tumbled more than 6% on August 18 alone and are now more



## Global equities retreat on growth, currency devaluation concerns

than 30% off their June peak, adding to worries over the health of China's economy. Stocks also continued to slide across other emerging markets, which hit a four-year low during the week amid steep outflows, according to the MSCI index.

### Fixed income

Growing concerns about China and falling commodity prices, which have weakened in tandem with currencies and declining global demand, fueled investor appetite for safe-haven assets. U.S. Treasuries and Eurozone government debt benefited from this "risk-off" environment, with the yield on the bellwether 10-year Treasury easing from 2.20% at the beginning of the week to 2.05% on August 21. (Yield and price move in opposite directions.)

While fixed-income markets have recently seen spreads widen to varying degrees across most sectors, returns for many non-Treasury assets, including investment-grade corporate bonds and mortgage-backed securities, were moderately positive for the week through August 20, based on Barclays indexes. Emerging-market debt, however, struggled, and high-yield bonds lost ground despite positive fund flows for the first time in four weeks.

Current updates are available [here](#). For additional insights on the high-yield market from TIAA-CREF portfolio manager Kevin Lorenz, view our [Weekly Market Perspective Video](#).

### The U.S. economy stays on track

The week's data releases support our view that the U.S. economy remains on a moderate growth trajectory. July releases were a bit soft, and August's are beginning to look the same, but revisions to June data continue to improve. Housing activity, which has been strengthening over the past few months, is likely to accelerate modestly through year-end. Against this backdrop, we expect second-quarter GDP growth to be revised upward to near 3%, while third-quarter growth may come in around 2.5%.

Among the week's reports:

- **First-time unemployment claims** increased to 277,000, and the less-volatile four-week moving average also edged higher, to 271,500, but levels remain indicative of a generally healthy labor market.
- **Housing starts** rose 0.2% in July to reach their fastest pace since October 2007, while starts for June were revised upward. Meanwhile, **homebuilder confidence** reached its highest level in almost 10 years in August, according to the monthly NAHB survey.
- **Existing home sales** notched a more than eight-year high in July, rising 10.3% compared to a year ago, according to the National Association of Realtors.
- After four consecutive months of strong gains, the index of **leading economic indicators** published by The Conference Board unexpectedly dipped 0.2% in July, largely because of a decline in building permits.

## Global equities retreat on growth, currency devaluation concerns

- **U.S. consumer prices** rose just 0.1% in July even as housing costs jumped 0.4%, their biggest monthly increase in more than eight years. We expect year-over-year prices, which climbed 1.8%, to steadily increase.
- **U.S. regional manufacturing indexes** were mixed, as the Philly Fed topped forecasts and the Empire State index tumbled to its lowest level since April 2009.

### Outlook

Equity market volatility increased in the past week amid headlines that focused on negative macro developments, particularly in overseas economies, rather than on positive news. Overall, fixed income continues to offer reasonable value given current yields and risks.

Although China's recent devaluation sent shockwaves through currency markets, the evidence now strongly suggests that Beijing was more interested in changing its currency-pegging process—and not weakening the yuan per se—in order to be included in the International Monetary Fund's reserve assets, known as the Special Drawing Rights. In fact, during the past week, China vigorously defended its currency, a practice we believe will continue for the foreseeable future, defusing fears of an ongoing devaluation.

Moreover, while we believe China is experiencing a cyclical slowdown, there are signs that its economy is bottoming. The consumer sector is stabilizing and real estate prices firmed in the past week.

We also believe Europe's economy will surpass expectations this year, with the European Central Bank continuing its aggressive quantitative easing through the end of 2016, supporting financial markets. Even Japan, whose GDP contracted in the second quarter, should benefit from further monetary easing and additional government spending.

In the U.S., a third-quarter slowdown may align with weaker overall global growth but does not threaten the recovery here at home. That said, the recent batch of softer data releases makes it harder for the Fed to begin raising rates in September. Until we receive a clear signal from the Fed that a hike is imminent, we think the odds favor a December liftoff.



Financial Services

TIAA-CREF Asset Management provides investment advice and portfolio management services to the TIAA-CREF group of companies through the following entities: Teachers Advisors, Inc., TIAA-CREF Investment Management, LLC, and Teachers Insurance and Annuity Association® (TIAA®). Teachers Advisors, Inc. is a registered investment advisor and wholly owned subsidiary of Teachers Insurance and Annuity Association (TIAA). Past performance is no guarantee of future results.

Foreign stock market returns are stated in U.S. dollars unless noted otherwise.

Please note that equity and fixed income investing involve risk.

© 2015 Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA-CREF), 730 Third Avenue, New York, NY 10017