Weekly Market Update

August's jobs report, September rate-hike fears, take a toll on equity markets

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Article Highlights

- U.S. and European stocks fall for the week, adding to August's steep decline.
- Treasuries remain stable amid equity market volatility.
- August's below-forecast employment report looks better than the headline suggests.
- China's economy and future currency moves remain a focal point for global markets.
- We are still positive on equities, expecting Europe to outperform the U.S.

September 4, 2015

Equities

Global equity markets endured more volatility during the past week. Investors grappled with concerns over a possible September rate hike by the Federal Reserve, additional disappointing economic data from China, and falling commodity prices. However, some strong European economic releases, along with a bounce in commodity prices, provided a midweek lift.

The S&P 500 Index, which fell 6.3% in August, its worst one-month return in more than three years, was on pace for a loss of about 3.6% for the week. Selling intensified on September 4 after the August jobs report bolstered the case that the U.S. economy had strengthened sufficiently for the Fed to raise interest rates later this month.

Meanwhile, manufacturing and service-sector activity in the Eurozone hit a four-year high in August, unemployment dropped to a more than three-year low in July, and retail sales rose solidly in July, providing fresh evidence of the region's recovery. The STOXX 600 Index, coming off of its biggest monthly loss in four years, lost 2.8% in local currency terms. That translated to a return of -3.71% in U.S. dollar terms, in part reflecting a drop in the value of the euro versus the dollar following dovish commentary from European Central Bank President Mario Draghi on September 3.

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Financial Services

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Stocks in China continued their slide in a holiday-shortened week that saw the country's manufacturing sector contract at its fastest pace in three years. Since hitting a peak in mid-June, Chinese equities have fallen more than 40%.

Fixed income

U.S. Treasuries traded within a relatively narrow range amid tight liquidity. After beginning the week at 2.18%, the yield on the bellwether 10-year note dipped to 2.13% during afternoon trading on September 4. (Yield and price move in opposite directions.) Credit spreads were also range bound, as investors awaited further economic news from China and rate-hike clues from the Fed. Returns for "spread" sectors (higher-yielding, non-U.S. Treasuries) were broadly, although not sharply, positive for the week through September 3.

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

Beneath the headline, August's job report looks better

August's payroll release was under special scrutiny, as it is one of the last major data releases prior to the Fed's September 16-17 meeting. (The September 15 U.S. retail sales report will also be closely watched.) The U.S. economy added 173,000 new jobs, well below forecasts. However, August's totals have been prone to upward revisions, as they have been seasonally weak, and payrolls for June and July were revised upward by a combined 44,000. Other labor measures were upbeat: The unemployment rate dropped to 5.1% (a seven-year low approaching full employment), the wage growth rate held steady at 2.2%, and average workweek hours increased.

Among the other reports:

- **First-time unemployment claims** increased to 282,000, and the less-volatile four-week moving average edged higher, to 275,500—levels that remain comfortably within a range indicating healthy labor markets.
- **U.S. manufacturing activity** softened to 51.1 in August, its slowest pace in more than two years, according to the Purchasing Managers' Index (PMI) published by the Institute for Supply Management (ISM). This reading, just above the 50 mark separating contraction from expansion, highlights a deceleration of U.S. industrial activity.
- **U.S. service-sector growth** exceeded forecasts, with the ISM index registering 59.1 in August. This was a slight dip from July's 10-year high, and while not a concern per se, we believe it may presage slower near-term growth.
- The **U.S. trade deficit** narrowed 7.4% ($3.3 billion) in July, as exports posted a small gain while imports fell, an indication that inventories will slide in the third quarter.

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Outlook

Even with the relatively modest addition to U.S. payrolls in August, job gains have averaged 221,000 per month over the last three months, between 75,000 and 100,000 more jobs per month than is needed to manage labor force growth. In short, the labor market continues to operate at about the same steady pace since the beginning of the year.

Along those lines, U.S. economic fundamentals are still on track, and the U.S. remains more insulated from foreign economic weakness than most other countries. Even though we expect a slowdown in third-quarter GDP—in a bit of a "giveback" from the second quarter—fourth-quarter data should pick up, buttressed by rising wages and a more confident consumer.

For U.S. equities, technical indicators suggest that the worst of the market's setback may be behind us. Investor sentiment has turned sharply lower, and less than 20% of the stocks in the S&P 500 Index are trading below their 50-day moving averages—two signs of a possible upturn. Our view is also supported by the recent outperformance of economically sensitive cyclical stocks versus more defensive shares, as well as a rebound in commodity prices.

That said, while we still expect the S&P 500 to advance from here, its upward move to year-end will not be in a straight line. Recoveries from sharp corrections take time, and we could see the index test its recent lows and encounter resistance in the 2,000 to 2,050 zone. Moreover, Fed-induced volatility should persist, and September has historically been the worst month for U.S. stocks.

Compared to U.S. equities, we believe European stocks offer better upside potential. Valuations are more attractive following August's downdraft, profit margins have stayed well below average, and economic reforms are beginning to kick in, especially in Italy, Spain, and France. However, there are caution flags ahead, including the refugee crisis, the Russia-Ukraine conflict, and upcoming elections in Greece and Spain.

China, meanwhile, continues to be the chief focus for both emerging and developed markets. Not only has its economy decelerated, but investors remain concerned about the government's intentions regarding the yuan after last month's surprise move to a "controlled float."

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