Weekly Market Update

Global equities take weak September jobs report in stride

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Article Highlights

- U.S. and European stocks turn the page on a bleak third quarter.
- Demand for safe-haven assets benefits Treasuries and hurts high-yield bonds.
- Despite the disappointing headline on September employment, there has been no material change to the U.S. economy's longer-term upward trajectory.
- We still believe the odds slightly favor a December rate hike, but the exact timing of rate "liftoff" is less important than the ultimate pace of tightening.
- Europe remains our favorite equity market, with attractive valuations compared to the U.S.

October 2, 2015

Equities

Global investors were eager to put the third quarter behind them, as equity indexes worldwide tumbled to multi-year lows for the three-month period ended September 30. The last two weeks of September are statistically the worst two weeks of the year and again lived up to that reputation.

Despite apprehension over China's weakening economy, slowing U.S. manufacturing data, and ongoing Fed-related uncertainty, the S&P 500 Index was down only modestly for the week through October 1. The index retreated early on October 2 in the wake of September's jobs report before reversing course to finish the week up about 1%.

Europe's STOXX 600 Index also rebounded on October 2 to return 0.5% for the week in U.S. dollar terms (-0.4% in local currency terms). In China, stocks fell slightly in a holiday-shortened week, while the economy showed some signs of stabilizing. Manufacturing data topped expectations, housing prices are rising, and the services sector is still expanding.

Financial Services

Fixed income

Fixed-income markets have taken on a decidedly pessimistic tone as a confluence of events has pressured risk assets, benefiting U.S. Treasuries. These events include negative headlines surrounding corporate bonds, concerns over emerging-market weakness, and Fed rate timing. In this “risk-off” environment, the yield on the bellwether 10-year U.S. Treasury fell steadily throughout the week, touching 1.98% during afternoon trading on October 2. (Yield and price move in opposite directions.) In contrast, high-yield bonds once again realized sharp losses.

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

U.S. job growth disappoints

The U.S. economy added just 142,000 new jobs in September, well below forecasts. August’s payrolls, which have historically been revised upward, were trimmed by 37,000, while July’s totals were also revised downward, by 22,000. Looking beyond the headline number, we note that September’s weakness came from a drop in mining and manufacturing employment, sectors closely tied to the recent downshift in energy production and a stronger dollar. In contrast, service- and consumption-related sectors held up well, and retail employment increased.

Among the week’s other reports:

- **First-time unemployment claims** came in at 277,000, marking the 30th straight week of claims below the key 300,000 mark—a streak not seen since 1973. Meanwhile, the less-volatile four-week moving average declined to 270,750.
- **Consumer spending** continued apace, with August’s brisk 0.4% increase matching July’s upwardly revised figure, and **personal income** lifted 0.3%. Incomes have risen steadily since the spring, buoyed by the improving jobs market.
- **Pending home sales** fell in August after inching up in July, and **U.S. home prices** climbed 0.6% in July and 5% compared to a year ago, based on the S&P/Case Shiller 20-City Composite Index.
- **U.S. manufacturing** slowed to 50.2 in September, its lowest level in two years and just above the 50 mark separating expansion from contraction, based on the Institute for Supply Management’s Purchasing Managers’ Index (PMI). Nonetheless, we believe this soft report is more the result of the recent downshift in the energy sector and a strong dollar than a material change in underlying demand across the country.
- Following August’s sharp rebound, The Conference Board’s index of **consumer confidence** increased moderately in September, supported by expectations for modest improvements in wage growth.

Outlook

September's employment and manufacturing data confirm that third-quarter GDP growth will end up slower than the second quarter's 3.9% showing. Nonetheless, we continue to see evidence of stable consumer demand, steady wages, and an uptrend in broader measures of income and consumption, all pointing to an economy that remains on an annual growth path of 2%-2.5%.

In terms of the Fed, we think the odds still slightly favor a December rate hike. This could change if employment data continues to weaken prior to the Fed's meeting on December 15-16, but the timing of the rate hike itself is less important to the economy than the ultimate pace of tightening.

In equity markets, Europe remains our favorite investment destination. Although U.S. equities are attractively valued on a relative basis given their very wide risk premiums, shares in Europe are even cheaper. Moreover, we believe Europe's equity markets offer superior growth potential given below-normal corporate profit margins and below-trend revenues.

As for China, the primary source of concern worldwide, we are cautiously optimistic that its equity markets are poised for a short-term rally on the back of a rebound in sentiment. Contributing to this improved outlook is our expectation for better fourth-quarter growth, buoyed by fiscal stimulus that may be announced sooner than markets anticipate. Even though such stimulus may not correct all of China's longer-term risks—including a potential housing bubble, a debt overhang, and overinvestments in infrastructure—it may boost investor sentiment and help spark a sharp rally in the emerging markets.

Fixed-income markets face headwinds from tighter liquidity and higher trading costs. However, if the Fed raises rates in December while adding a vote of confidence for the U.S. economy, we believe most fixed-income spreads can rally. Overall, fund flows will remain an important consideration, as outflows have forced institutional investors to sell positions they would normally have held.

Financial Services

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