Weekly Market Update

Equity markets extend their October advance

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Article Highlights

- U.S. and European stocks rally late in the week, erasing earlier losses.
- Continuing rebound in emerging-markets equities pushes month-to-date gain above 9%.
- Treasuries benefit from mixed U.S. data and the market's view that the Fed won't hike rates until 2016.
- We expect the S&P 500 to move higher in Q4, with corporate earnings key to an upswing.
- In our view, investment-grade and high-yield corporate bonds are priced fairly, with low default risk.

October 16, 2015

Equities

Global equity markets enjoyed a second straight positive week. In the U.S., the S&P 500 Index edged 0.5% higher, bringing its October return to 6%. The index's 1.5% gain on October 15 alone was notable, as this solid performance occurred despite a down day for oil and commodities—a signal that investors are perhaps becoming less fearful of a slowdown in China and are beginning to focus on improving U.S. economic activity and corporate earnings.

In Europe, the STOXX 600 Index finished the week up 0.3% in U.S. dollar terms (0.1% in local terms). With profit margins in Europe still offering plenty of room for expansion, we believe stocks there have more upside than U.S. shares. Meanwhile, Chinese equity markets surged despite reports of slowing trade and weak inflation, as investors cheered the introduction of fresh stimulus plans from Beijing and the prospects for additional government intervention.

Fixed income

U.S. Treasuries rallied on mixed economic releases and, no less importantly, a market view that the Federal Reserve may wait until 2016 to raise interest rates. The yield on the bellwether 10-year U.S. note, which began the week at

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2.12%, dipped to 1.99% on October 14—an almost six-month low—before touching 2.03% on October 16. (Yield and price move in opposite directions.)

The possibility of a delay in Fed rate "liftoff" helped stabilize "spread" sectors (higher-yielding, non-U.S. Treasuries), whose returns were broadly positive for the week, although investment-grade corporate bonds realized a modest loss. Fund flows into high-yield and emerging-market debt reached their highest levels in five months.

Current updates are available here. For additional insights from TIAA-CREF Head of Global Active Equity Portfolio Management Saira Malik, view our Weekly Market Perspective Video.

A mixed week for U.S. economic reports

The past week's slate of data releases showed additional signs of labor-market strength and a notable pick-up in consumer prices compared to a year ago. Among the reports:

- **First-time unemployment claims** fell to 255,000, while the less-volatile four-week moving average declined to 265,000. Both figures matched 42-year lows.
- **Regional manufacturing** contracted in October, as both the Philly Fed and the Empire State manufacturing index slowed sharply.
- **Retail sales** edged up a disappointing 0.1% in September from August's downwardly revised figure. Despite this soft report, we still believe consumer spending will provide a boost to the U.S. economy heading into year-end.
- **U.S. consumer prices** declined 0.2% in September, largely because of a steep drop in gasoline prices. Stripping out volatile food and energy costs, so-called "core" inflation increased a scant 0.2% in September but rose 1.9% over the past 12 months.
- **Consumer sentiment** improved after three straight monthly declines, based on the preliminary October reading of the University of Michigan index. Against a backdrop of low inflation, ongoing job growth, and a slower rate of economic expansion, consumers expressed optimism that they would be able to vary the pace of their spending without losing confidence in the U.S. recovery.
- **Small business sentiment** was little changed in September, as measured by the National Federation of Independent Business optimism index; uncertainty over the timing of the Fed's next rate hike a source of concern.

Outlook

For U.S. stocks, October's rally appears to confirm our view that the August-September downdraft was a correction and not the beginning of a bear market. We believe the pullback was rooted in sharply declining oil-patch activity, inventory "destocking" from the second quarter, and headwinds from a rising dollar, all of which are effects that should begin to ebb.

Equity markets extend their October advance

Technical indicators suggest the S&P 500 may move higher from here: Investor sentiment remains firmly negative, and the index breached its 60-day moving average on October 14—two signs of a possible further advance. Our outlook is also supported by corporate earnings that, while not robust, have been encouraging. With roughly 10% of companies reporting, almost 80% have beaten estimates. Strong earnings are essential to underpinning a fourth-quarter rally. That said, we are still cautious about a number of issues, including the potential for a U.S. government shutdown and heightening tensions in the Middle East.

In fixed-income markets, we believe that investment-grade and high-yield corporate bonds are priced fairly, with default risk staying low and any Fed rate hike likely to be modest (even in 2016). Additionally, the modest but directionally positive trend in oil prices continues to bolster beaten-up energy, gas, and commodities companies. While fears of a deceleration in China seem to have abated slightly, key Chinese economic releases next week could have implications for bond markets.

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