Weekly Market Update

Healthy drop in equity markets may be setting the stage for a stronger year-end finish

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Article Highlights

- The S&P 500 Index ends its six-week winning streak.
- Softer economic data and falling commodity prices contribute to the market's retreat.
- European equities end the week down nearly 3% amid tepid GDP growth in the Eurozone.
- U.S. Treasury yields edge lower, while higher-yielding credit sectors see spreads widen.
- We view the current decline in U.S. equities as a healthy pullback that offers buying opportunities.
- Many fixed-income categories could rally as Fed rate hike uncertainty diminishes.

November 13, 2015

Equities

U.S. equities endured a sharp reversal in the past week. The S&P 500 Index was down 2.5% through November 12 and heading lower as of mid-day trading on November 13. Lukewarm economic readings, capped by a meager rise in retail sales, contributed to the downturn, as did a continuing slide in prices for oil, copper, and other commodities. The S&P 500 is now more than 4% below its November 3 peak.

International markets followed the U.S. lower. Europe's STOXX 600 Index lost roughly 3% for the week against a backdrop of disappointing third-quarter GDP growth in the Eurozone (+1.2% on an annualized basis). The slowdown in the region was due largely to weaker exports to developing countries. More broadly, MSCI foreign developed- and emerging-markets benchmarks posted returns of -0.8% and -2.2%, respectively, through November 12. Japanese equities bucked the negative trend, with the Nikkei 225 Index climbing more than 1.5% for the week. The rise in Japan came amid a weakening of the yen, which bolsters Japanese exports.

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Fixed income

U.S. Treasuries benefited as mixed international economic reports and lackluster U.S. retail sales tempered the market's view of the road to higher interest rates, at least temporarily. Treasury yields declined modestly during the week. As of afternoon trading on November 13, the 10-year note was poised to close below 2.3% for the first time since November 5. (Yield and price move in opposite directions.)

Meanwhile, spreads generally widened for non-Treasury credit sectors, both in anticipation of volatility ahead of a December rate hike and because of the sell-off in oil, which affects select emerging-markets energy exporters and nearly one-fifth of high-yield bond issuers. Net flows into most fixed-income asset categories were small to negative, reflecting continued investor reticence to add to bond positions.

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

Employment indicators remain strong despite softness in other U.S. economic releases

Among the mixed economic data released during the week were lower-than-expected retail sales, which were up only 0.1% in October (+0.3% when gas and auto sales are stripped out). Additionally, September's figure was revised downward (to 0%), and August was also flat. Inflation at the producer (wholesale) level was similarly weak, falling 0.4% in October and 1.6% versus a year ago.

Those signs of weakness, however, were not confirmed in any way by U.S. labor markets. On the heels of October's robust non-farm payrolls report, which showed that the U.S. economy created 271,000 jobs last month, the past week's employment releases remained strong:

- **Initial jobless claims** were unchanged in the first week of November and continue to plumb levels not seen since the mid-1970s, when total employment was far below today's levels.
- **Job openings**, as measured by the Labor Department's JOLTS survey, rose to a near-record level of 5.53 million in September.

Consumers appear confident as well. According to November's preliminary reading, the University of Michigan's Consumer Sentiment Index rose for the second month in a row, to a higher-than-expected level of 93.1.

Outlook

In our view, the current pullback in the U.S. equity market is both healthy and to be expected, coming off the S&P 500's almost uninterrupted 13% rise from September through October. Sentiment has now been reset, and investors are wary of stocks, evidenced by accelerating outflows from equity funds. Year to date, these outflows have totaled $140 billion, almost equal to 2008 levels. If the U.S. economy does in fact improve, and the dollar stabilizes as we expect going into next year, there could be a substantial reversal of outflows.

In addition, hedge fund net exposures to equities have fallen into firmly bearish territory—in our experience, a likely harbinger of a subsequent market upturn. Overall, we believe the market's most recent downturn creates buying opportunities, and that at a year-end close at or above 2,200 for the S&P 500 is still in scope.

Turning to fixed income, issuance remains high as companies and countries try to lock in financing at current rates. Emerging-markets debt appears reasonably priced ahead of what we expect will be a modest December rate hike accompanied by reassuring rhetoric from the Fed. In fact, many fixed-income asset categories could rally as Fed rate uncertainty is removed from the marketplace. Reduced liquidity in bond markets remains a concern, however, and we could see volatility increase in the final weeks of 2015.

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