Weekly Market Update

Global equities feel the pain of falling commodity prices

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Article Highlights

- U.S. equities stumble, relinquishing year-to-date gains, while European shares slump to a two-month low.
- Reduced risk appetite benefits Treasuries, hurts high-yield bonds.
- Recent trend of lackluster U.S. economic data continues.
- Despite caution flags, we believe the S&P 500 could approach previous highs.
- Volatility during the Fed's expected tightening cycle may offer fixed-income opportunities.

December 11, 2015

Equities

During the past week, concerns over the Federal Reserve's widely expected rate hike were joined by anxiety over steep declines in global commodity prices. Surging supply sent the price of the West Texas Intermediate crude oil benchmark to under $36 a barrel on December 11, a near seven-year low.

The S&P 500 Index fell 1.9% for the week through December 10 and was on pace for a 3.8% loss for the full week. The potential deflationary effects of some lackluster economic readings also contributed to the pullback.

European equity investors expressed continued disappointment over the weaker-than-expected monetary easing measures announced by the European Central Bank (ECB) on December 3. The broad STOXX 600 Index plunged 4% for the week in local currency terms. The euro ticked higher against the dollar during the week, trimming this loss to about 3.3% in dollar terms. For the Eurozone economy, improvements in leading economic indicators, dovetailed with fiscal stimulus designed to boost security and support the refugee flow, could lead to an upside surprise in GDP and drive domestic demand.

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.

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Fixed income

Treasuries rallied in this risk-off environment. The yield on the bellwether 10-year Treasury note closed at 2.13% on December 11 after beginning the week at 2.28%. (Yield and price are inversely related.)

Among non-Treasury securities, high-yield corporate bonds suffered their worst week of outflows in more than a year. For the year to date through December 10, this asset class has returned -3.5%. Leveraged-loan and emerging-markets debt funds were also hit by outflows. Spread widening was exacerbated by tight liquidity heading into year-end. Total returns for spread sectors ranged from modestly positive to slightly negative.

U.S. economic data fails to impress

It was a relatively light week for U.S. data releases. Although economic indicators have been trending down of late, the jobs market remains a relative bright spot.

- **First-time unemployment claims** increased by 12,000, to a five-month high of 282,000, but this rise was likely the result of seasonal adjustments around the holidays. The less-volatile four-week moving average, considered a more accurate predictor of labor-market direction, edged up by only 1,250, to 270,750. Meanwhile, job openings (as measured by the JOLTS report) fell but remained at a healthy level.
- **Small business sentiment** declined in November, according to the NFIB, the result of slower sales and growing inventories.
- **Retail sales** inched higher in November (+0.2%), in line with forecasts (+0.4% excluding autos).
- **Consumer confidence** rose in November, to 91.8, but fell short of expectations, according to December's preliminary reading of the University of Michigan index.

Outlook

In our view, the effects of the Fed's likely interest rate hike on other major central banks bear watching. For example, we believe the ECB is hoping for a dramatic rise in the dollar following the Fed's move, mirrored by a weaker euro—one of the objectives of the ECB's quantitative easing program. If the dollar strengthens only slightly, the ECB may be forced to announce further stimulus, perhaps during the first half of next year.

In Asia, there is less need for the Bank of Japan (BOJ) to augment its monetary policy. As long as the Japanese economy and inflation rate keep moving in the right direction, gradual rate hikes by the Fed should not lead to more aggressive BOJ easing. Meanwhile, more stimulus is needed in China, even as the Chinese economy appears to be stabilizing. The People's Bank of China (PBoC) has focused on gradually weakening the yuan, which has fallen about 4% since the beginning of August and may fall a bit further. Fortunately, markets have generally shrugged off this decline, in stark contrast to their behavior when the PBoC's currency weakening during the summer set off a global equity selloff.

For U.S. stocks, we believe the S&P 500 could find its footing and advance toward previous highs above 2,100. Short-term trading sentiment has turned sharply lower, a contrarian indicator that may provide a springboard for an advance into next year. To illustrate, investors have pulled some $150 billion out of equity mutual funds and exchange-traded funds this year alone—more than the amount withdrawn during the 2008 recession and bear market.

In fixed income, we are keeping a wary eye on widening credit spreads, to the extent that they may signal rising defaults and economic weakening. For now, this widening may be the result of technical factors as the bond market discounts Fed tightening while simultaneously reacting to weaker U.S. economic data. On balance, we believe fixed-income assets are reasonably valued, but there will likely be better opportunities to take advantage of Fed-related volatility beginning in the first quarter of next year.