



Weekly Market Update

Equity markets end a bleak January on an upbeat note

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Article Highlights

- Japanese rate cut surprises markets, but slower U.S. GDP growth does not—a net plus for global equities during the week.
- U.S. Treasuries benefit from the move to negative rates in Japan and the Fed's dovish outlook.
- Oil prices rise again in hopes of coordinated production cuts to ease supply glut.
- We now expect only one Fed rate hike in 2016, while expanded monetary stimulus in Europe is a near certainty.
- The worst of the equity market downdraft may be behind us, but upward moves from here will not be in a straight line.

January 29, 2016

Equities

Global equity returns were broadly positive for the second week in a row, with U.S. and foreign markets rallying on the Bank of Japan's (BoJ's) surprise move to lower the rate it pays on excess reserves into negative territory (-0.1%). The unexpected action marked the Japanese government's latest attempt to jumpstart inflation and boost the country's flagging economy.

Also lending support to markets was a rebound in oil prices amid speculation that Russia and OPEC may be entering discussions for a coordinated cut in production. On the U.S. economic front, GDP growth slowed in the fourth quarter, but markets were relieved that the degree of deceleration was in line with expectations.

After closing as low as 1,859 in recent weeks, the S&P 500 Index reclaimed levels well above 1,900 and finished the week with a gain of 1.7%. Europe's STOXX 600 Index climbed about 1.2%. In Japan, the Nikkei 225 Index's more than 3% rise for the week helped lift many other Asian markets. Even Chinese equities rallied on January 29, though not enough to push into positive territory for the week.

Current updates to the week's market results are available [here](#).



Financial Services

Fixed income

U.S. Treasuries rallied on the week, even as equities and oil prices climbed. The 10-year Treasury yield began the week at 2.06% and closed at 1.92% on January 29. (Yield and price are inversely related.) Driving the decline in yields was dovish language accompanying the Federal Reserve's January 27 announcement that it was holding rates steady, and that the pace and scope of future rate hikes would reflect global economic developments as well as the usual domestic metrics. Treasuries also benefited late in the week on the heels of the BoJ's rate cut, which boosted the dollar and made U.S. assets more attractive.

Based on Barclays indexes, non-Treasury markets also produced generally positive returns for the week, with spreads improving as many of the risks now facing the market appear to be priced in. High-yield bonds in particular were notable for realizing gains for the first time in three weeks.

Slow U.S. GDP growth matches expectations

As expected, GDP growth in the U.S. fell to an annualized rate of 0.7% in the fourth quarter of 2015, according to the government's advance estimate. Consumer expenditures held up, driven by spending on services. In contrast, spending on durable goods (such as aircraft, machinery, computer equipment, and other big-ticket items) was lackluster. Inventory and capital spending was also weak. A potential silver lining in the GDP data is that it suggests inventory levels will soon run low, implying an increase in inventory spending in the next quarter or two.

Among the week's other data releases:

- **First-time unemployment claims** declined by 16,000, to 278,000, and the less-volatile four-week moving average also fell, by 2,250, to 283,000. New claims remain at low levels that could signal a potential increase of about 200,000 jobs in the next monthly payrolls report, to be released on February 5.
- **New home sales** surged 10.8% in December compared to November, and were 9.9% higher versus a year ago.
- **Home prices** also increased, rising 5.8% year-over-year in November, according to the S&P/Case Shiller 20-City Composite Index.
- **Consumers' outlooks** were mixed in January, with The Conference Board's consumer confidence index rising more than expected, and the University of Michigan's consumer sentiment gauge ticking slightly lower.

Outlook

After the Fed's latest statement, we anticipate a halt in further rate hikes until economic measures and financial markets improve further. As usual, the Fed will leave the door open to raising rates based on incoming data, but given muted wage growth, inflation, and other economic variables, it's doubtful we'll see another move before the second half of this year at the earliest. We now expect only one rate hike in 2016, based on the current direction of growth.

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Meanwhile, the BoJ's negative rate policy demonstrates how concerned the Abe administration is about the lack of progress being made to reinflate the Japanese economy. Whether Japan's surprise move represents the beginning of the next round of global monetary easing remains to be seen, but we do think it increases the likelihood—and scope—of another boost to quantitative easing by the European Central Bank. While further easing will please markets, it also indicates that central bankers are having to resort to ever-more expansive stimulus efforts to have a meaningful impact.

Against this backdrop, global equity markets appear to be finding stability after what has been a painful start to the new year. In our view, the worst of the downdraft may be behind us, and the next move for the markets should be up. A number of factors support this view:

- U.S. economic activity, while slower, is positive and likely to accelerate.
- Fourth-quarter earnings releases remain favorable, with over 70% of companies beating expectations so far.
- Corporate buybacks are set to resume in February after their earnings-related pause. In addition, very large private equity “war chests” are itching to be put to work at newly lower prices.
- Extremely negative sentiment is at levels that historically have preceded stock-market rallies.

That said, any market recovery to new highs will likely occur in a slow and choppy “stair step” trajectory. Moreover, global economic and geopolitical risks remain and bear watching.

In fixed income, we see the potential for reduced volatility as investors appear to be more comfortable with the current state of global affairs. We believe credit risk in investment-grade corporate bonds, as well as higher-quality high-yield bonds and loans, currently represents fair value. Inflation risks remain low, providing a tailwind to credit markets generally. In emerging markets, spreads have benefited from the likelihood of slower rate moves by the Fed.



Financial Services

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