Weekly Market Update

Equities try to find their footing after turbulent week

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Article Highlights

- U.S. and European stocks pare losses with late-week support from energy and bank stocks.
- In a continued flight to quality, investors seek U.S. Treasuries and avoid high-yield bonds.
- Labor market data remains firm, but consumers send mixed messages.
- While steady U.S. economic activity should help stocks stabilize, a concern is that equity market weakness could spill over into the broader economy.
- Fixed income assets appear fairly valued despite potential market risks that we are monitoring closely.

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Equities

Equity markets stumbled this past week, as investors added the health of the financial sector and the effectiveness of central bank policies to lingering concerns over global economic growth. Stocks staged a comeback on February 12, however: rumors of a cut in crude production by members of OPEC sent oil prices soaring from a 13-year low, bolstering energy shares, and bank stocks also rebounded. Overall, the S&P 500 Index lost about 0.7% for the week, while Europe's STOXX 600 Index slipped 4.1% (in local terms).

In Asia, Japan's Nikkei 225 Index plunged 11% (in local terms), its worst week since October 2008. Meanwhile, the yen—considered a safe haven during times of global economic stress—capped off a strong two-week run against the U.S. dollar. The stronger yen trimmed Japanese equity losses when translated into dollars. Chinese equity markets were closed for the week in observance of the country's Lunar holiday and will reopen on February 15.

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Financial Services

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Current updates to the week's market results are available here.

Fixed income

U.S. Treasuries rallied in the week's predominantly risk-off environment, benefiting from strong demand for safe-haven assets. The yield on the bellwether 10-year note, which began the week at 1.86%, fell to 1.63% on February 11, its lowest level since May 2013, before rising to 1.73% the next day as risk appetites improved. (Yield and price move in opposite directions.)

Based on Barclays indexes, returns for non-Treasury fixed-income markets were mostly positive, led by commercial mortgage-backed securities. Net outflows continued to hinder high-yield corporate bonds, which have returned -5.2% for the year to date through February 11. Emerging-market (EM) debt modestly outperformed high-yield bonds, as the prospect of further dollar weakness—driven by potentially slower-than-expected Federal Reserve tightening—has supported EM growth prospects at the margin.

More signs of strength from the U.S. labor market

In a light week for U.S. data releases, the job market remained a relative bright spot. Among the week's economic reports:

- **First-time unemployment claims** dropped by 16,000, to 269,000, and the less-volatile four-week moving average also fell, by 3,500, to 281,250.
- **Small-business sentiment** edged lower in January, according to the National Federation of Independent Business optimism index; business owners expressed concerns about the near-term outlook for business conditions and sales growth.
- **Retail sales** topped forecasts by rising 0.2% in January, and sales in December were revised upward to 0.2% (from a 0.1% decline).
- **Consumer confidence** eased to 90.7, based on the preliminary February reading of the University of Michigan index. Consumers had a less favorable near-term outlook for the economy, while their longer-term prospects were still favorable.

Outlook

The bearish trend gripping equity markets since the beginning of the year has given us pause. Although we ultimately believe the positive (albeit slow) growth of the U.S. economy will help stabilize markets, our concern is that these equity declines could depress economic activity. A U.S. multinational technology company, for example, recently reported that customers had decided to suspend orders until they were more certain that the equity sell-off wasn't a sign of a deeper economic malaise. Encouragingly, the S&P 500 Index has managed to hold at certain key support levels, and investor sentiment remains deeply negative—a contrarian indicator than has often presaged higher stock prices.

In the meantime, fixed-income assets remain reasonably valued, though we are closely monitoring the possibility of further market weakness and spread widening. It appears that Treasury yields will finish the year much lower than we expected just six weeks ago. In our view, the 10-year note's diminishing yield (from 2.24% at the start of 2016 to levels around 1.75%) reflects a potential slowdown—but not a contraction—of the U.S. economy, as well as heightened global demand for U.S. debt given the low or negative rates available abroad. For example, Japan's 10-year yield reached negative territory for the first time during the past week, meaning investors effectively paid for the privilege of lending money to the Japanese government.