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Volatile oil prices and global growth concerns drive equities lower

TIAA GLOBAL ASSET MANAGEMENT

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Article Highlights

- The S&P 500 Index gives up some of its year-to-date gains, and European stocks extend their losing streak.
- Non-Treasury fixed-income assets maintain their rally, led by investment-grade corporate bonds.
- In our view, encouraging Chinese economic data is tempered by the possibility of Beijing's further devaluation of the yuan.
- While U.S. equities remain vulnerable to a near-term market pullback, an improving economy supports our view that the S&P 500 should be able to reach new highs this year.
- Increased bond issuance could pressure fixed-income spreads, although we expect higher oil prices to benefit high-yield performance.

Equities

Global stocks were volatile in the past week, as markets pivoted along with oil prices while fretting over global economic health. In the U.S., the combined effects of an extended market and overly bullish investor sentiment exerted a toll as well. For the week, the S&P 500 Index lost about 1.2%, pushing it back toward negative territory for the year to date through April 8.

In Europe, investors also weighed mixed economic data. The Eurozone's services and manufacturing sectors continued to expand, and German exports grew at their fastest pace in five months in February, driven mainly by European demand. On the downside, orders for German manufacturers unexpectedly dropped. The broad STOXX 600 Index staged a late-week rally but still fell 0.4% for the week (in local currency terms), its fourth straight weekly decline.

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

Fixed income

Broad concerns over the global economy boosted demand for safe-haven assets such as gold, U.S. Treasuries, and the Japanese yen—which hit a 17-month high versus the U.S. dollar on April 7. The yield on the bellwether 10-year Treasury fell to 1.72% on April 8 after beginning the week at 1.78%. (Yield and price move in opposite directions.)

Non-Treasury “spread sectors” continued to perform well, with investment-grade corporate bonds a notable outperformer. Year to date through April 7, they have returned a robust 4.80%, based on the Barclays index. Tight supply and the longer duration of these bonds relative to other fixed-income assets have bolstered returns. Investment-grade corporates have also benefited from the decision of the European Central Bank (ECB) to include Eurozone corporate bonds as part of its asset purchases. This has had a positive effect on U.S. dollar corporates, many of which are issued by European companies.

China and its currency are in focus

In a relatively light week for U.S. economic releases, oil prices and the prospects for global growth dominated the week’s headlines. In our view, though, developments in China warrant closer attention. On a positive note, Chinese economic news has been encouraging, including a rebound in leading economic indicators, rising exports, and increased bank lending. At the same time, however, we are keeping an eye on the direction of China’s currency. Although Beijing has gradually guided the yuan higher since December, recently the yuan has slipped on a trade-weighted basis against a basket of currencies. This gives us pause.

During some previous periods of currency depreciation, China has tapped into a vast war chest of foreign-exchange reserves to ward off speculators betting on further declines and to stanch capital outflows. This prior success may give Chinese government officials confidence in their ability to engineer a period of renewed weakness versus the dollar. If they were to attempt this, markets could destabilize just as they did last summer, when China’s actions sparked fears of a slowdown and ignited a global selloff.

Outlook

For U.S. equities, investor sentiment has reached bullish levels, and more than 90% of S&P 500 Index stocks are trading above their 50-day moving average. These indicators have historically presaged a market pullback, which is what we continue to anticipate in the near term.

Our longer-term outlook for U.S. stocks remains positive, underpinned by an improving fundamental backdrop. Leading economic indicators are rising, the dollar has weakened, the services sector keeps humming along, and the UBS Growth Surprise Index is trending higher for the first time in almost a year. (This index tracks a host of economic indicators. It rises or falls when these indicators come in higher or lower, respectively, versus consensus expectations.) On balance, we maintain our view that the S&P 500 should be able to hit new highs by year-end.

In fixed-income markets, spreads could come under pressure, as we expect increased issuance across investment-grade and high-yield corporate bonds, as well as structured products such as asset-backed and commercial mortgage-backed securities. At the same time, we believe high-yield bonds will rally, supported by higher oil prices. Fixed-income assets overall are fairly priced given modest default levels and the Fed's likely "go-slow" approach to increasing interest rates this year.

Disclosures

TIAA Global Asset Management provides investment advice and portfolio management services through TIAA and over a dozen affiliated registered investment advisers.
Foreign stock market returns are stated in U.S. dollars unless noted otherwise.

Please note that equity and fixed income investing involve risk.

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