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Markets welcome positive news on China, oil prices, and earnings

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Article Highlights

- The S&P 500 adds to its year-to-date gains, and European stocks snap a four-week losing streak.
- High-yield bonds are the star performers in an otherwise quiet week for fixed-income markets.
- Retail sales and consumer confidence disappoint, while the job market keeps delivering.
- Although the extended U.S. equity market is ripe for a correction, we view a pullback as a buying opportunity.
- The "Brexit" vote may add to market volatility, but a greater concern may be the IMF's potential withdrawal from last summer's Greek bailout.
- We expect fixed-income volatility to pick up as the credit sector rally loses steam.

Equities

Global stocks performed well this past week, helped by some better-than-expected earnings releases—especially from large global banks—and positive economic news out of China. Equities were further buoyed as oil extended its rally, which eased fears about stress in the energy sector and banks' exposure to commodity-related debt. Oil prices have been supported, in part, by hopes that major producers will agree to freezing output in a meeting in Doha, Qatar, on April 17.

The S&P 500 Index rose about 1.7% for the week, bringing its year-to-date return to over 4.0%. Since hitting a two-year low on February 11, the index has jumped roughly 14%. After falling for four straight weeks, Europe's broad STOXX 600 Index rose 3.3% (in local currency terms), its first weekly advance since March 11. The recent declines may have reflected uncertainty around the June 23 referendum on Britain's possible exit ("Brexit") from the European Union. Although current polls show the outcome is too close to call, we believe the U.K. will remain in the EU fold.

On April 18, China reported first-quarter GDP growth of 6.7%, its slowest quarterly expansion in seven years but one in line with expectations and the government's own growth targets. Meanwhile, China's exports rebounded sharply in March, and inflation, industrial output, and retail sales all picked up. Of greater importance is that China's currency strengthened late in the week. On a technical basis, the yuan remains in a pattern that, for now, eases our concerns that Beijing will engineer another bout of currency depreciation. Against this positive backdrop, Chinese equities posted solid gains.

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

Fixed income

Fixed-income markets enjoyed a week of low volatility. The yield on the bellwether 10-year Treasury, which began the week at 1.72%, edged up to 1.75% on April 15. (Yield and price move in opposite directions.)

Returns for non-Treasury "spread sectors" were mixed. Asset-backed and commercial mortgage-backed securities posted small losses, while high-yield bonds surged 1.55% for the week through April 14
on favorable demand/supply dynamics, rising oil prices, and positive fund flows. Year-to-date, high-yield bonds have returned 5.42%.

Job market strength is countered by flagging retail sales and falling sentiment
The past week's economic releases contained a few disappointing reports. Among the data:

- **Retail sales** ended the first quarter on a down note by unexpectedly falling 0.3% in March. February's previous small decline was upwardly revised to show no change. With this soft reading, we are reducing our first-quarter GDP forecast to 1.2%, closer in line with fourth- quarter's growth.

- **First-time unemployment claims** plunged by 13,000, to 253,000, matching their lowest level since 1973. The less-volatile four-week moving average declined by 1,500, to 265,000, near a post-recession low.

- **Small-business sentiment** fell to a fresh two-year low, as measured by the index published by the National Federation of Independent Business. Owners expressed concerns over the economy and the lack of clear direction in Washington.

- **Regional manufacturing** continued to rebound, with the Empire State Index reaching its highest level in more than a year. The dollar's drop over recent months, which has made U.S. exports more competitive, has helped. In contrast, **industrial production** fell in March, the sixth decline in the past seven months.

- **Consumer sentiment** slipped for the fourth straight month, according to April's preliminary reading of the University of Michigan index. Consumers were somewhat pessimistic over the future pace of job creation and a possible slowdown in wages, but they expected conditions to improve as the economy recovers from a rocky first quarter.

Outlook

U.S. economic growth will be slower this year (about 1.8%) than it was in 2015 and 2014, with a reduction in consumer spending roughly offset by a modest rebound in net exports. Job creation should remain healthy over the medium term, although it appears to be decelerating.

We still believe that U.S. equities can reach new highs in 2016, although the upward climb will not occur in a straight line. The S&P 500 remains extended, and on April 12, the International Monetary Fund (IMF) lowered its forecast for global growth in 2016. This raises the likelihood of a 5% to 10% correction, but we would view such a pullback as a buying opportunity.

Our outlook for European equity markets is bolstered by evidence of a domestically driven recovery, economic reforms, a recapitalized banking system, lower unemployment consumer confidence, and the gradually fading impact of fiscal austerity. Although the possibility of a Brexit has garnered most of the headlines and will add to market volatility, we believe a greater concern is the pronouncement by the IMF that it may pull out of the last summer's bailout deal between Athens and Eurozone creditors. If this were to occur, it could trigger yet another sovereign debt crisis in the second half of the year.

For fixed income, near-term volatility is likely to pick up as the rally in credit sectors loses steam and the Brexit vote approaches. Longer-term, investors will focus on the limits of central bank policy as well as China's ability to manage the ongoing risks associated with its economic slowdown. In terms of valuations, we believe bonds are reasonably priced under current market conditions.

For additional insights on the global economy and financial markets, read our 2016 Second Quarter Economic and Investment Outlook.

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