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Global equities advance in a quiet week

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Article Highlights

- U.S. and European stocks post gains, notching multi-month highs during the week.
- High-yield bonds shine once again, while weak demand hurts U.S. Treasuries.
- Labor market data remains solid, but the housing market sends mixed messages.
- Europe is still an attractive equity market destination even as the region faces a number of political issues.
- In Asia, Japan's central bank may unveil further easing, while a key for China is how long the government can sustain the economic imbalances it has created.

Equities

Global stocks advanced this past week, continuing to track the recovery in oil prices. In the U.S., the S&P 500 Index reached a 4½-month high on April 20 and gained about 0.5% for the week. Year to date through April 22, the index is up 3.0%.
In Europe, the broad STOXX 600 Index rose for the second straight week (+1.7% in local terms), hitting a multi-month high along the way. Recent data releases have been encouraging: German economic sentiment strengthened for the second straight month in April, and Eurozone consumer confidence also rose. Moreover, with its deep trading ties to the emerging markets—and in particular, to Russia, a major oil exporter—Europe has the most to gain from improvements in developing economies.

Japan's Nikkei 225 index returned roughly 4% (in local terms) for the week on the back of a weaker yen and hopes of further easing by the Bank of Japan. Year to date through April 21, the index is down almost 20% in local terms, as the yen has strengthened significantly, confounding expectations. With this downdraft, we now believe Japanese shares are inexpensive.

Broad emerging-markets equities added to their impressive showing (+8.0% in dollar terms year to date through April 21, based on the MSCI index), aided by a weaker dollar and rising commodity prices. Chinese equities, in contrast, endured their worst one-week showing in three months, even as the Chinese economy seems to have found its footing.

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

Fixed income

Demand for U.S. Treasuries slipped during the week's prevailing "risk-on" environment. After beginning the week at 1.76%, the yield on the bellwether 10-year note reached 1.88% trading on April 22. (Yield and price move in opposite directions.)

Returns for non-Treasury "spread sectors" were broadly negative, although high-yield bonds bucked that trend by returning 1.1% for the week (+6.6% year to date) through April 21. Underpinned by the oil rally, high-yield energy bonds, which make up about 20% of the overall high-yield market, have surged roughly 30% since late January. Investment-grade and high-yield corporates, along with emerging-markets debt, remain in strong demand.

A mostly down week for U.S. economic data

In a familiar refrain, positive news on the jobs front was tempered by manufacturing weakness. Housing data was mixed, supporting our view that this sector will not be a primary driver of growth this year.

- **First-time unemployment claims** fell by 6,000, to 247,000, the lowest level in 42 years, and the less-volatile four-week moving average also dipped, by 4,500, to 260,500.

- After rising sharply in March, **the Philly Fed manufacturing index** unexpectedly slowed in April. Despite this decline, firms that were surveyed expect better business conditions over the next six months.

- **Existing home sales** soared 5.1% in March, while February's pace was revised slightly downward. **Homebuilder confidence** held steady in April for the third consecutive month, based on the NAHB/Wells Fargo index. Overall, builders are still cautiously optimistic that the solid job market and low mortgage rates will bolster the housing market in the coming months.

- **Housing starts** slumped 8.8% in March to their lowest level in five months but were 14.2% higher than a year ago. **Building permits**, a forward-looking indicator, also fell in March.

- The **Citi Economic Surprise Index** turned lower. This index gauges the extent to which economic data releases diverge from consensus forecasts; rising index levels indicate more upside surprises.

Japan ponders its next move

The Japanese economy continues to struggle, with near-zero GDP growth and flagging inflation despite aggressive monetary easing by the BoJ and fiscal stimulus under Prime Minister Shinzo Abe. Complicating matters is the yen's unexpected rise since the BoJ adopted negative interest rates in late January. A stronger yen both lowers import prices, which tamps down inflation, and makes Japan's exports less competitive overseas.

The BoJ is likely to announce fresh stimulus, perhaps at its next meeting on April 28. One possible measure includes buying more exchange-traded funds (ETFs); the BoJ already purchases ¥3 trillion (about $28 billion) in ETFs each year as part of a broader ¥80 trillion asset-purchase program.

Outlook

In the U.S., we still believe the S&P 500 is ripe for a correction after climbing rapidly off its mid-February lows. Such a decline would be a buying opportunity, in our view, as we expect U.S. stocks to reach new highs by year-end. Fixed-income credit sectors may rally further if the Federal Reserve continues to signal patience on potential rate increases, although demand may wane following an equity market correction.

Overseas, Europe remains an attractive equity market destination even as the region faces a number of political issues. These include the refugee crisis, Great Britain's potential exit from the European Union, Spain's fiscal woes, and the reemergence of a Greek/European sovereign debt battle this summer.

As for China, the key global growth engine, the government has reopened its stimulus "playbook" via increased infrastructure spending. The key issue, though, is how long officials can sustain the economic imbalances they have created. For example, debt levels are rising, as are non-performing bank loans. Meanwhile, real estate prices are near "bubble" territory. A collapse of the real estate market could severely damage consumer spending and further impair the banking system, leading to a "hard landing" for the economy. One advantage is that China's financial system is closed and "self-funded," allowing the government wide access to manage economic stress.

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