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TIAA

Mid-Year Economic and Investment Outlook

Is slower growth the new normal?

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Executive Summary

- The U.S. economy picked up steam in the second quarter, though growth will likely moderate in the coming months.
- While the June “Brexit” vote delivered a shock to markets, the short-term volatility resulting from this event has not changed our long-term outlook.
- We think U.S. stocks can reach new highs but still favor European equities on a relative basis.
- Low interest rates and global growth concerns should boost demand for bonds that offer both higher yields and higher quality.
- The low-growth, low-inflation environment means the Fed will be in no hurry to resume interest-rate hikes.

Asset class preferences

Equities ↔	**Fixed Income** ↔
Large Cap ↓	Government Debt ↓
Mid Cap ↑	United States ↓
Small Cap ↑	Europe ↔
Growth ↓	Japan ↔
Value ↑	TIPS ↑
Developed Markets ↓	Munis ↔
United States ↓	Corporate (Investment Grade) ↑
Europe ↑	High Yield ↑
Japan ↔	Emerging Markets (USD) ↓
Emerging Markets ↑	Emerging Markets (LC) ↑

↑ = overweight; ↓ = underweight. TIPS = Treasury Inflation-Protected Securities. LC = Local currency. Allocations based on an unhedged, U.S.-dollar-denominated portfolio. Please note the forecasts above concern asset classes only and do not reflect the experience of any product or service offered by TIAA. These forecasts are for informational purposes only and should not be considered investment advice or constitute a recommendation to purchase or sell securities. Market forecasts are subject to uncertainty and may change based on varying market conditions, as well as political and economic developments. Past performance is not an indicator of future results.

United States

Economy

Despite some longer-term headwinds, the U.S. is arguably in the best shape of all the world's major economies. Consumers are starting to spend more, wages are finally beginning to accelerate modestly, and businesses have made progress improving their bottom lines. Annualized GDP growth rates should remain in the 1.75% to 2.25% range for the remainder of this year. Inflation expectations remain low, so the Fed is in no hurry to resume raising interest rates.

Stocks

Our fundamental outlook for U.S. equities is generally positive. In particular, we see attractive opportunities in cyclical sectors (those that tend to perform well when the economy is expanding), such as Consumer Discretionary, Energy, Technology, Industrials, and Financials. Overall, we think the S&P 500 Index can reach new highs by year-end, but there will be some volatility along the way.

Bonds

U.S. bond market performance was broadly positive in the first half of 2016. Looking ahead, demand for higher-quality fixed-income assets such as U.S. Treasuries and other top-rated investment-grade securities will outstrip demand for the riskiest segments of the market, as investors will be seeking both yield *and* quality.

Non-U.S. developed markets

Economy

Fallout from the U.K.'s June 23 vote to leave the EU will dominate Europe's economic landscape for some time, primarily because of continued political uncertainty. We expect the Eurozone to register 1.5% second-quarter GDP growth, slowing slightly in the second half of the year. In Japan, first-quarter growth of just under 2% will likely dip toward zero as the year proceeds.

Stocks

European stocks lagged U.S. shares during the first half of 2016. However, we continue to favor the region despite Brexit-fueled uncertainty, as valuations and earnings prospects are both attractive relative to the S&P 500. A sharp pullback in the Nikkei 225 Index has created potential investment opportunities in select Japanese blue-chip companies with strong balance sheets, but yen strength could derail a second-half rally.

Bonds

Although the Eurozone is already awash in negative-yielding debt, government bond yields in Germany and other core countries in the region could decline further as the European Central Bank extends its quantitative easing program. Unless the Japanese government implements a large fiscal stimulus program, which we don't anticipate, yields in Japan are likely to stay on their downward path.

Emerging markets

Economy

Circumstances vary widely across emerging-market (EM) countries and regions. Among larger economies, Brazil is currently in a deep recession but faces brighter long-term prospects thanks in part to an aggressive reform agenda, while China continues its delicate balancing act as it transitions to a more domestically focused, slower-growing economy.

Stocks

EM equity markets outperformed their developed-market counterparts in the first half of 2016, supported by stabilizing oil prices, stronger EM currencies, and the "lower-for-longer" interest-rate stance taken by the world's major central banks. After five years of underperformance, EM stocks may finally be at an inflection point.

Bonds

EM bonds have also rallied year-to-date, surpassing other global fixed-income sectors by a wide margin. This strong run could make EM debt vulnerable to a subsequent downturn. We would view this as a buying opportunity, with compelling investment potential to be found in both local-currency and U.S. dollar-denominated markets.

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