Weekly Market Update

Jobs report propels U.S. equities to a strong finish

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- A late-week rally helps the S&P 500 reverse earlier losses in a volatile week.
- April's payroll numbers signal decent jobs growth but no increased risk of an earlier Fed rate hike.
- Global fixed-income markets endure a surge in long-term yields.
- Economic data in the Eurozone continues its upward trend.
- U.S. equity valuations, while not cheap, remain below historical highs.

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Equities

April's solid jobs release salvaged the week for U.S. equities. The S&P 500 Index was down nearly 1% for the week through May 7, hurt by a surge in U.S. Treasury rates. The index rebounded on May 8, however, as investors saw the monthly payrolls report as strong enough to suggest improved economic footing following a weak March, but not so robust that the Federal Reserve would significantly accelerate its tightening timetable.

European equities also rose despite severe volatility in Eurozone bond markets and ongoing concerns about Greece. A better-than-expected showing for the Conservative Party in U.K. elections helped, reducing political uncertainty and increasing the likelihood of policies perceived as more market-friendly.

Fixed income

Global fixed-income markets were volatile. In Europe, the spike in yields that followed a failed German bond auction in late April continued during the past week. Germany's 10-year yield hit 0.80% early on May 7 before settling below 0.60% the next day. Better economic data and heightened inflation expectations fueled the sharp jump in yields, while continued bond buying by the European Central Bank (ECB) helped stanch further increases.

U.S. Treasury yields also rose. After beginning the week at 2.12% and reaching 2.25% on May 7—the highest level in more than four months—the yield on the bellwether 10-year note closed at 2.16% on May 8, in part because April's jobs

Financial Services

report included a downward adjustment to March's jobs data, indicating a greater degree of labor market weakness than previously thought.

Although "spread products" (higher-yielding, non-U.S. Treasury securities) posted negative returns for the week through May 7, they were surprisingly resilient compared to their performance during the rise in rates that marked the May 2013 "taper tantrum."

Current updates are available here. For additional investment insights from TIAA-CREF Global Investment Strategist Dan Morris, view our Weekly Market Perspective Video.

A mostly solid jobs reports caps a mixed week for U.S. data releases

The U.S. economy created 223,000 jobs in April, roughly in line with or only slightly below most forecasts. Additionally, March's already modest total (+126,000) was adjusted downward, to 85,000—a surprise given our expectation for an upward revision, and further evidence that the month was far weaker than we had anticipated. Meanwhile, the unemployment rate edged down from 5.5% to 5.4%, its lowest level since 2008. Wage growth rose by just 0.1% in April and 2.2% over the past 12 months. In our view, this report will not provide the impetus for the Fed to raise rates at its June meeting, so a September time frame remains the odds-on favorite.

Among the week's other releases:

- **First-time unemployment claims** ticked up to 265,000 but remained near a 15-year low, and the less-volatile four-week average dipped to 279,500.
- **Non-manufacturing activity** expanded in April, with the Institute for Supply Management (ISM) index rising to 57.8, topping forecasts. (Readings above 50 indicate expansion.)
- The **U.S. trade deficit** soared 43% to $51.4 billion in March, the highest level since 2008. Hampered by the strong dollar, exports rose only slightly (+0.9%), while imports surged a record 7.7%, buoyed by the end of the West Coast port shutdown. Given this wide trade gap, we believe first-quarter GDP growth (+0.2%) will be revised downward later this month, perhaps to -0.5% or lower.

More signs of economic progress in Europe

Economic data out of the Eurozone was largely positive. The region's manufacturing sector slowed in April but remained in expansion territory, while the European Commission lifted its growth forecast for the Eurozone from 1.3% to 1.5% amid cheaper oil, a weaker euro, and aggressive quantitative easing by the ECB. Countries that have made the greatest efforts toward reforms (such as Ireland and Spain, which reported plummeting unemployment in April) have shown the most improvement.

Outlook

The past week's equity market volatility is to be expected as the market begins to price in a hike in the federal funds rate and an eventual normalization of the overall interest-rate environment. In our view, expected returns for U.S. equities relative to bonds remain attractive, although that would change if the yield on the 10-year Treasury were to breach 3%. We don't believe such a rate increase will occur this year, however, given the moderate pace of recovery in the U.S. and continued demand for Treasuries from investors seeking higher yields than those available in Europe.

Sentiment levels could also support higher equity prices, as both short- and long-term measures remain firmly in negative territory, a potential precursor to a market rise. At current price-to-earnings (P/E) ratios of 17x-18x earnings, stocks are not cheap, but their valuations are well below historical highs (25x-35x earnings) that often accompany overly optimistic sentiment.

In fixed-income markets, we think U.S. yields will remain tied to global events, including inflation/ deflation trends and shifts in sentiment. U.S. debt appears reasonably priced at current levels, with a bias toward higher rates by year-end.