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TIAA GLOBAL ASSET MANAGEMENT

# Caution weighs on global equity markets as the Fed comes into focus

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**Article Highlights**

- In a rocky week, the S&P 500 edges higher, while Europe's STOXX 600 Index loses ground.
- Rising yields hurt Treasuries and non-Treasuries alike.
- Continued solid labor-market data is one of the few bright spots in a lackluster week for U.S. economic releases.
- We believe opportunities to buy riskier fixed-income assets may improve in the coming months.

## Equities

Global equities endured a volatile week, as investors assessed conflicting comments from Fed officials regarding the possibility of the central bank raising interest rates at its highly anticipated September 20-21 meeting. Wide swings in oil prices added to the uncertainty.

In the U.S., the S&P 500 Index appears to have fully awakened from its summer slumber. In a week that saw back-to-back one-day returns of 1.47% and -1.45%, the index gained 0.5%. Europe's broad STOXX 600 Index declined 2.2% (in local currency terms), its poorest one-week showing in three months. Japanese stocks also stumbled, with the Nikkei 225 Index falling 3% (in U.S. dollar terms) for the week through September 15, as investors braced for the Bank of Japan's next policy meeting, which coincides with the Fed's.

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

## Fixed income

A change in sentiment driven by the potential for higher rates has affected global markets, as evidenced by rising long-term government bond yields in Europe and the U.S. After beginning the week at 1.67%, the yield on the bellwether 10-year U.S. Treasury rose to 1.73% on September 13, its highest level since early June, before closing at 1.69% on September 16. (Yield and price move in opposite directions.)

Returns for non-Treasury "spread" sectors were broadly negative for the week through September 15.

## A lackluster week for U.S. data releases

During the past week, more assuring data from the U.S. labor market was tempered by disappointing small business sentiment and retail sales. The manufacturing sector also showed signs of struggling, while consumer prices rose more than expected. Among the reports:

- **First-time unemployment claims** inched up by 1,000, to 260,000, as did the less-volatile four-week moving average, by 500, to 260,750. Claims have stayed below the key 300,000 level for 80 straight weeks, the longest such stretch since 1970.
- **Small-business sentiment** declined in August, as measured by the NFIB Optimism Index. Business owners expressed concerns about the uncertain political climate and the near-term outlook for business conditions.
- **Retail sales** declined 0.3% in August, their first drop in five months, but July's sales were adjusted slightly upward.
- **Regional manufacturing** gauges improved in August, although the Empire State Index remained mired in contraction territory. On a positive note, the Philly Fed showed moderate growth. Disappointingly, **U.S. industrial production** fell 0.4% in August after upward revisions to the previous two months.
- **U.S. consumer prices** rose 0.2% in August, topping expectations, and 1.1% compared to a year ago. Stripping out volatile food and energy costs, so-called "core" inflation increased 0.3% in August, its biggest gain since February, and a healthy 2.3% over the past 12 months.
- **Consumer sentiment was unchanged,** according to September's preliminary reading of the University of Michigan index, even as consumers remained reasonably optimistic about their economic prospects.

Lastly, as reported by the U.S. Census Bureau, real median household income surged 5.2% from 2014 to 2015, its first annual increase since 2007.

## Outlook

For the U.S. economy, we expect third-quarter GDP to come in at 2% or slightly higher. (The government's advance estimate will be released on October 28.) As long as businesses continue to hire, wages and consumer demand should follow. That means the economy could continue to post growth rates above 2% going forward, but 3% or higher is unlikely.

In fixed-income markets, we still believe high-grade corporate bonds offer reasonable value and should offer some principal protection if rates do indeed rise, given the asset class' reduced sensitivity to interest-rate changes. The opportunity to buy riskier assets such as lower-quality high-yield corporate bonds, emerging-market debt denominated in local currencies, and lower-rated structured credit may improve in the coming months. Also looking ahead, volatility in fixed-income prices, credit spreads, and U.S. Treasury yields are likely to pick up should we see increased geopolitical uncertainty and inconsistent economic releases. Markets will likewise be influenced by central banks, starting with the upcoming Fed and Bank of Japan policy meetings.

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