Weekly Market Update

Equity markets rise amid hopeful developments in Europe

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Article Highlights

- U.S. and European stocks rise as tensions in Europe ease, if only temporarily.
- Although investors hope for a quick resolution to the Greek debt crisis, protracted negotiations are likely.
- Germany and the Eurozone post better-than expected fourth-quarter GDP growth.
- Improved risk appetite lowers demand for U.S. Treasuries.
- U.S. economic data largely disappoints, but we expect key growth trends to continue.

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Equities

It was a broadly positive week for equities. Optimism stemmed in large part from news of a cease-fire agreement between Russia and Ukraine and a pickup in oil prices, coupled with some positive economic surprises in Europe.

U.S. equities shrugged off weak domestic economic data and rising U.S. Treasury yields, with the S&P 500 Index posting a second straight week of gains and finishing at a new all-time high. Cyclical stocks have led the recent upturn, suggesting the market anticipates future economic improvements driven by consumption.

Stocks in Europe also gained ground, as Germany's economy grew much faster than expected, fueling hopes for a broader economic recovery in the region. Chinese equities gained following three successive weeks of losses, as China's central bank pumped another 160 billion yuan ($26 billion) into the banking system on February 11, adding to earlier stimulus. The key risk in China remains the fragile property market.

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

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Fixed income

The yield on the bellwether 10-year Treasury, which moves in the opposite direction of its price, rose modestly during the week. Despite several disappointing U.S. economic releases, including declining retail sales numbers and higher jobless claims, brighter news out of Europe trimmed demand for safe-haven assets, pushing the 10-year yield above 2% for the first time in a month.

Returns for spread products, (higher-yielding, lower-rated non-U.S. Treasuries) were mixed. Positive fund flows supported returns for better-quality high-yield corporate bonds and emerging-markets debt, while returns for investment-grade corporate bonds were slightly negative.

U.S. economic reports are underwhelming—but not unexpected

The past week's U.S. data releases were soft across the board, in line with our expectations for a slowdown in economic activity to start the year. The retail sales report, while disappointing at the surface, showed some signs of resiliency by consumers.

- **Retail sales** fell 0.8%, a weak showing even for a slow month like January. Sales excluding autos also declined significantly, by 0.9%. However, when factoring in falling gasoline purchases—lower prices at the pump have more than offset increased demand—retail sales actually increased 0.2%, a sign that spending is holding up. This report indicates that reduced fuel prices have not yet translated into higher spending, but we expect that to change during the year as consumers become more accustomed to cheaper gas and are willing to loosen their purse strings.

- **Consumer sentiment** fell from an 11-year high amid worries over slowing economic growth, as measured by February's preliminary reading of the University of Michigan/Thomson Reuters Index. Still, the index finished at its second-highest level since 2007.

- **First-time unemployment claims** rose 25,000, to 304,000. On a positive note, U.S. **job openings** hit their highest level since 2001, according to the Job Openings and Labor Turnover (JOLT) report. This points to even stronger jobs growth in coming months.

- **Small business sentiment** slipped in January after reaching an eight-year high in December, according to the NFIB small-business optimism index. The biggest factor affecting January's reading was a decline in expectations for business conditions over the next six months.
- **The Citi Economic Surprise Index** turned sharply lower. This index is a gauge of the extent to which economic data readings have diverged from consensus forecasts.

Upside surprise in Germany's GDP growth helps boost the Eurozone economy

Eurozone GDP expanded by a greater-than-expected 0.3% in the fourth quarter of 2014, with Germany, the region's largest economy, growing by 0.7%. Results for other major European economies were mixed: Spain also expanded 0.7%, but France (+0.1%) and Italy (+0%) could not keep pace. Greece's economy contracted (-0.2%). Although GDP gains were modest, they provide a measure of optimism that fresh monetary stimulus from the European Central Bank, a weakening euro, and improvements in loan growth will hasten economic progress. .

Outlook

We are not overly concerned about the recent deceleration of U.S. economic activity. Our expectations are that key growth trends in the areas that matter most—payrolls, wages, and consumption—will continue. Capital expenditures by businesses should also pick up. We are maintaining our first-quarter GDP growth forecast at 2.5%, which is in line with the latest data.

For U.S. equities, sentiment is at a bearish level—often a precursor to a market upturn. Notably, in January, investors sought to rein in risk by withdrawing more than $17 billion from equity exchange-traded products and adding over $7 billion to fixed-income portfolios. Against this backdrop and with the S&P 500 at a new all-time high, we would not be surprised to see a correction of up to 10% in the coming months.

The standoff between Greece and its international creditors bears watching. Of particular concern is that an acceleration of deposit outflows from Greek banks could lead to Greece's exit from the Eurozone. That, in turn, could result in a run on deposits in some of the region's weaker economies, such as Spain, Portugal, and Italy. While elements of a potential compromise over Greece's debt load have fueled market hopes for a quick agreement, we expect protracted and difficult negotiations.

In fixed-income markets, we see value in U.S. high-yield and investment-grade corporate bonds, commercial mortgage-backed securities, and select emerging-markets debt issued by oil importers. We will remain focused on conditions in the U.S. labor markets in order to assess the timing and scope of future interest-rate movements.