TIAA GLOBAL ASSET MANAGEMENT

Solid October jobs report fails to help the S&P 500 snap its losing streak

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Article Highlights

- U.S. equities fall for the ninth consecutive day, extending the prior week's losses. European stocks also decline for the second straight week.
- Treasuries rally amid pre-election jitters, while outflows and tumbling oil prices hurt high-yield bonds.
- As we expected, a scarcity of labor supply has translated into a slower pace of job creation, putting upward pressure on wages.
- Policy statements from the White House winner could offer clues to the direction of interest rates.
- We maintain our preference for non-U.S. stocks in both the developed and emerging world.

Equities

Heightened uncertainty over the U.S. presidential election and falling oil prices largely defined the week's disappointing equity market performance. A spike in U.S. crude inventories, coupled with renewed skepticism that the world's major oil producers will be able to implement supply cuts at their upcoming November 30 summit, pushed prices down about 8% for the week (to $44/barrel) and 15% from their 2016 high reached in mid-October.

While acknowledging that a case for a rate increase had "continued to strengthen," the Federal Reserve left its benchmark federal funds rate unchanged at its November 1-2 meeting. This widely expected decision had little effect on equity markets or on fed fund futures, which still strongly point to a rate hike when the Fed meets in December.

In the U.S., third-quarter earnings season remained in full swing, with more than 85% of S&P 500 Index companies reporting. Encouragingly, firms have topped earnings and sales estimates by an average of 5% and 3%, respectively. However, neither this positive news, nor a solid but slightly below-forecast jobs report, released on November 4, could prevent the S&P 500 from falling for a ninth straight day dating back to October 25. During this losing streak, its longest since 1980, the index has declined by about 3%. For the week, the index lost about 1.9%

U.S. election jitters spilled over into Europe, whose broad STOXX 600 Index concluded its worst week in nine months (-3.5% in local currency terms). Economic news for the region, though, was upbeat, as Eurozone manufacturers enjoyed their best month since April 2014. Significantly, new orders hit a 2½-year high, which should help sustain the improvement, and businesses hired additional workers at the fastest pace in more than five years. Inflationary pressures continued to build, with input costs rising at their quickest clip in 15 months.

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

Fixed income

With the election looming, investors sought the relative safety of U.S. Treasuries. After starting the week at 1.85%, the yield on the bellwether 10-year U.S. note fell to 1.78% on November 4. (Price and yield move in opposite directions.)

In contrast, demand for select non-Treasury "spread sectors" was soft; returns ranged from modestly positive to strongly negative. In particular, high-yield bonds struggled amid steep outflows and falling oil prices, as energy firms—including coal, shale, and oil-related pipeline and exploration companies—comprise about 20% of the below-investment-grade debt market.

As we had anticipated, U.S. jobs growth has slowed while wages have accelerated

The U.S. labor market kicked off the fourth quarter by adding 161,000 jobs in October, slightly less than forecast but likely enough to keep the Fed on track to raise interest rates next month. The unemployment rate dipped to 4.9% from 5%. Average hourly wages rose 0.4% in October and a healthy 2.8% over the past year, the most rapid 12-month advance since 2009. The labor force participation rate edged down to 62.8% but has risen slightly since last October.

We've been expecting labor markets to tighten, leading to rising wages and decelerating job growth as employers struggle to find workers to fill positions. Indeed, employment gains in 2016 have averaged 181,000 per month, versus 229,000 per month in 2015. In our view, both of these trends will extend through next year.

Among the week's other reports:

- **First-time unemployment claims** increased by 7,000, to 265,000 as did the less-volatile four-week average, by 4,750, to 257,750.
- **Inflation,** as measured by the Fed's preferred inflation barometer (the PCE index), rose 0.2% in September and 1.2% over the past 12 months, the largest one-year advance in nearly two years. Excluding food and energy costs, the "core" PCE index edged up just 0.1% in September but a more robust 1.7% versus a year ago.

- **Consumer spending** rose 0.5% in September, another factor boosting the likelihood of Fed action by year-end. Supported by employment gains and wage growth, consumers should be able to push the economic recovery further along.

- **Manufacturing activity** picked up steam in October, with the index published by the Institute for Supply Management (ISM) rising to 51.9, a three-month high. (Readings above 50 indicate expansion.) **U.S. factory orders** jumped 0.3% in September, their third straight month of gains. In addition, August's total was revised upward, providing further cautious optimism that a manufacturing turnaround may be in store.

- In contrast, **service-sector growth** slowed, to 54.8, according to ISM's non-manufacturing index, but remains at a healthy level.

- The **trade deficit** plunged 10% in September, to $36.4 billion, a 19-month low. Despite the headwinds from a rising dollar, exports hit their highest level since last summer, outpacing imports, which dipped to a four-month low.

Outlook

We maintain our preference for non-U.S. stocks in both the developed and emerging world. Price and earnings momentum, along with lower valuations, all point to further gains in overseas markets. Significant risks remain in Eurozone financial companies and in specific political hotspots in emerging markets, but those uncertainties appear to be appropriately reflected in current share prices.

Regardless of which party captures the White House, we expect fixed-income volatility to increase for the rest of the year, creating potential buying opportunities among spread-sector credits. Policy statements from the winner of the election could offer clues to the direction of interest rates.

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