TIAA-CREF Asset Management

2015 Second Quarter Investment Outlook: Watching the Fed

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For an in-depth analysis, please see our full 2015 Second Quarter Investment Outlook:

https://www.tiaa-cref.org/public/pdf/2q15_outlook_watching_the_fed.pdf

Executive Summary

- Investor anticipation about when and how quickly the Fed raises interest rates will influence markets almost as much as the hikes themselves; expect ongoing volatility.
- While the coming increase in rates will likely spark temporary weakness in equities, the Fed's action is fundamentally positive as it reflects steady U.S. economic growth.
- Above-average valuations and low earnings growth potential in the U.S. mean international equity markets are more attractive, but U.S. investors need to be mindful of currency risk.
- The increase in U.S. Treasury interest rates will be driven not only by Fed hikes but by mounting inflation expectations; foreign demand, though, will moderate the rise in yields.
- The income from higher-yield, higher-risk parts of the bond market will bolster total returns even as rates rise, though selectivity is key.

Asset class preferences

Equities ↑	**Bonds** ↓
U.S. Equities ↓	U.S. Treasuries ↓
International ↑	Corporate Bonds ↑
Emerging Markets ↑	High-Yield Bonds ↑
	Emerging Markets ↑

Data as of March 31, 2015. ↑ = overweight; ↓ = underweight. Please note the forecasts above concern asset classes only and do not reflect the experience of any product or service offered by TIAA-CREF.
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TIAA CREF
Financial Services

United States

Economy

The U.S. recovery is continuing at a modest pace. Pent-up consumer demand and rising housing activity are likely to support economic growth for several years.

Stocks

U.S. equity valuations appear stretched and the outlook for earnings growth is weakening. We look for growth to outperform value, while higher-yielding sectors might lag once interest rates move up.

Bonds

The Fed is expected to begin raising interest rates in the second half of 2015. Higher-yielding parts of the market, both domestically and abroad, should offer some protection against price declines.

International

Economy

Quantitative easing (QE) in Europe and Japan ought to lead to weaker currencies and a higher level of exports. Reform efforts in Europe may finally be gathering steam, adding a boost to the cyclical recovery already in place.

Stocks

Liquidity from QE and pension fund allocation changes in Japan should support equity markets. Margins in Japan are low compared to those in the U.S., so potential earnings growth is commensurately higher.

Bonds

Central bank support means international bond yields are likely to remain low, while they appear poised to rise in the U.S. Weaker currencies, however, will offset some of the gains for U.S. investors.

Emerging markets

Economy

China's growth rate continues to disappoint, though service and domestic-oriented sectors are doing better. To appeal to foreign investors, some emerging-market central banks will need to follow the Fed in raising interest rates, adding a drag on economic growth.

Stocks

More modest currency depreciation should allow U.S. investors to capture more of the gains in emerging-market equities. Asia is the more attractive region, as scandals in Brazil and the crisis in Russia hinder the other regions.

Bonds

The spread over developed-market bonds is attractive, particularly for U.S. dollar debt, but depreciating currencies pose a threat to some high-yield issuers. Selectivity is key.