



Weekly Market Update

Small-cap stocks lead equity markets higher

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Article Highlights

- Equities in the U.S. rise, while U.S. Treasury prices end slightly lower.
- Stocks in Europe and the emerging markets advance.
- Minutes from the Fed's April meeting offer no clues about the next interest-rate hike.
- Investors may be disappointed by the European Central Bank's decision at its June meeting.
- We expect stocks to move higher by year end, but future gains for bonds may be limited.

May 23, 2014

Equities

U.S. equities moved up for most of the past week through early trading on May 23, boosted by positive economic reports that included better-than-anticipated data from the manufacturing sector. The S&P 500 Index rose more than 1%, while the small-cap Russell 2000 Index advanced 1.6% as it continues to stabilize following a sharp fall from its peak on March 2. Based on MSCI Indexes, foreign developed- and emerging-market equities were in positive territory for the week through May 22.

Fixed income

After dropping sharply during the week ended May 16, the 10-year U.S. Treasury yield rose slightly this past week, from 2.52% to 2.56%. (Yields move in the opposite direction of prices.) Fund flows into fixed-income sectors remained supportive, but we expect that the vast majority of this year's bond returns may have already been realized. In overseas markets, Spanish and Greek bonds were bolstered by rating upgrades following softness the prior week.

Current market updates are available [here](#).



Financial Services

Fed meeting minutes take center stage in a light week for U.S. data

With few economic reports to digest, markets appeared to focus on the most recent Federal Open Market Committee meeting minutes, which disclosed no change in the Fed's assessment of U.S. economic activity or on the pace of tapering. However, the central bank did discuss several approaches to raising rates without indicating when it might actually do so.

Fed Chair Janet Yellen has thus far been able to allay market fears by indicating that rates are likely to stay low for a "considerable time" after the Fed wraps up its bond-buying program. But investors have already begun to play "armchair quarterback" regarding the central bank's next steps, and calls for more specific information over the timing of a fed funds increase will intensify over time. This will induce the Fed to communicate its plans sooner and more clearly than it would like.

News from the Fed aside, economic releases from the past week were mostly positive. Among the notable reports:

- The "flash" (preliminary) Markit Purchasing Managers Index hit a three-month high of 56.2 in May, indicating that conditions remain on the upswing in the U.S. manufacturing sector. (Readings above 50 signal expansion.)
- The Conference Board's index of leading economic indicators increased 0.4% in April after a 0.8% rise in March.
- In April, existing home sales rose 1.3% to their highest level in four months, and sales of new single family homes rose 6.4%, ahead of forecast.
- First-time jobless claims were higher than forecast, increasing to 326,000 from last week's 298,000. However, four-week moving averages, a less volatile indicator, have stayed relatively stable. Moreover, monthly job creation measures have been shifting upwards. We still believe the employment picture will improve, with most of the gains occurring toward the end of the year. Our forecast is for the U.S. economy to add between 200,000 and 225,000 jobs in May.

Markets continue to await the ECB's decision on monetary easing

The European Central Bank (ECB) has been signaling a willingness to enact accommodative monetary policies that may have the effect of boosting inflation and weakening the euro.

Investors expect the ECB to take action at its next meeting on June 5, with some beginning to call for a U.S.- style policy of quantitative easing, an outcome we deem unlikely. The anticipation of accommodative monetary policy by the ECB has supported European shares throughout the year. Their 4.7% gain (year to date through May 22) makes them the world's top equity performers. Concerns remain, though, that the market's expectations may be ahead of probable action by the ECB.

Outlook

In coming months, policy communication will once again become a critical issue for the Fed, and so will risk of increased market volatility, as investors try to determine how and when the central bank will raise short-term interest rates. We continue to believe that the next cycle of interest-rate hikes will begin toward the end of 2015; on balance, the U.S. economy appears to be improving, and significant inflation pressures have yet to materialize.

In equity markets, we still think the S&P 500 has further room to run before a correction is likely. However, we see such a downturn as a buying opportunity, anticipating the market to reach higher levels by the year's conclusion.



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Foreign stock market returns are stated in U.S. dollars unless noted otherwise.

Please note that equity and fixed income investing involve risk.