Weekly Market Update

With equity markets on hold, Treasuries rally following weak March jobs report

WILLIAM RIEGEL, CHIEF INVESTMENT OFFICER, TIAA-CREF ASSET MANAGEMENT

- In holiday-shortened trading week, global equity markets are in waiting mode.
- Prices for U.S. Treasuries rise in response to March's surprisingly soft employment data.
- We anticipate a quick rebound in hiring and an acceleration of the U.S. economy in Q2.
- Further evidence of a eurozone revival prompts us to raise our GDP forecast for the region.
- At current levels, we believe stocks offer better value compared to bonds.

April 3, 2015

Equities

Global equities meandered amid light trading in a week shortened by the Good Friday holiday, as investors were cautious prior to the April 3 release of March's U.S. employment report. March 31 marked the end of a volatile first quarter for the S&P 500 Index, which rose just 1.0% for the period, compared to 18.5% for eurozone stocks (in local terms, according to the MSCI index). For U.S. investors, the dollar's sharp appreciation versus the euro trimmed that gain to 5.20%.

Japan's Nikkei 225 Index rallied during the week and returned about 11% (in both local and U.S. dollar terms) for the first quarter, with purchases by pension funds and the Bank of Japan propping up share prices. In spite of this strong performance, we remain somewhat skeptical of future gains in Japan's equity markets.

Fixed income

Treasuries had been moving in a narrow range before the March jobs report sent their prices up and their yields down. (Price and yield move in opposite directions.) In mid-day trading on April 3, the yield on the 10-year Treasury, which began the week at 1.95%, had dropped to 1.84%, a two-month low. "Spread products" (higher-yielding, lower-rated non-U.S. Treasury securities) were largely range-bound during the week.

TIAA CREF

Financial Services

With equity markets hold, Treasuries rally, weak Mar. jobs report

Current updates are available here. For additional insights from TIAA-CREF Global Investment Strategist Dan Morris, view our Weekly Market Perspective Video. Dan's Q2 outlook, "Watching the Fed," can be found here.

Despite the March payrolls data, we still see the U.S. economic picture brightening

The U.S. economy added just 126,000 jobs in March, well below forecasts, including our own. Of greater concern was that January and February payrolls were revised down by a combined 69,000, slowing the average monthly job gain to 197,000 in the first three months of the year. In the 12 months prior to March, employment growth averaged 269,000 per month. Wages, always a key focus, increased 0.3% in March and 2.1% on a year-over-year basis, both close to forecasts.

Other reports released during the week pointed to a pickup in activity that should serve as a springboard for better economic performance in the second quarter. Among the releases:

- **First-time unemployment claims** fell by 20,000, to 268,000—near a post-recession low—and the less-volatile four-week moving average also declined significantly, to 285,500.
- The Conference Board's index of **consumer confidence** rose in March from an upwardly revised level in February amid optimism over the labor market.
- **Pending home sales** climbed to a 20-month high in February after a downward revision to January's number.
- **U.S. home prices** held steady in January and were up 4.6% on a year-over-year basis, based on the S&P/Case-Shiller 20-City Composite Index. We believe this measure of housing prices recently bottomed and will start rising, with year-over-year gains reaching 7% by year-end.
- **Auto sales** bounced back in March from February's snow-strapped total.
- **U.S. manufacturing activity** increased in March to 55.7, well above the 50 mark separating expansion from contraction, according to Markit's Purchasing Managers Index (PMI). A similar manufacturing index published by the Institute for Supply Management (ISM) declined in March to 51.5.
- **Consumer spending** ticked up just 0.1% in February following January's 0.2% drop.

Eurozone growth gathers more momentum, but Greece remains a major concern

European economic activity continues to be encouraging. Markit's Eurozone Manufacturing PMI hit 52.2 in March, a 10-month high, and business confidence jumped to its highest level in almost four years. Moreover, deflationary conditions in the region are easing, and German unemployment touched a new record low of 6.4%.

Meanwhile, international creditors are evaluating Greece's latest—and most comprehensive—reform plan to date but have yet to unlock any bailout funds. Our primary concern remains the potential for a run on Greek bank deposits that could increase the odds of Greece's exit from the eurozone.

Outlook

Although it is possible that the downdraft in U.S. jobs growth signaled an economy approaching full employment, we believe the March report reflects the vestiges of the severe winter and job cuts in the energy sector. Consequently, we anticipate a return to stronger job gains as early as next month, and the already steady improvement in wages to accelerate during the second half of the year. This will lead to a more confident consumer and more consistent, broader annual economic growth in the neighborhood of 3%. We expect the unemployment rate, which held stable at 5.5% in March, to approach 5.0% at full employment.

For the Fed, consistent wage increases buy time before making a final decision to raise interest rates. If we are indeed already at full employment and job growth slows, wage gains will accelerate more quickly, suggesting a faster rate-hike scenario.

In Europe, Germany remains the economic bright spot. German growth will benefit countries across the periphery of the region—except Greece. The eurozone is accelerating at a faster pace than we expected, and the European Central Bank's balance sheet is expanding—a sign that quantitative easing is taking hold. Accordingly, we are increasing our forecast for annual GDP growth in the Eurozone from 0.9% to 1.5%, which is still below consensus estimates.

For U.S. stocks, our base case remains an intermediate target of 2,150 for the S&P 500, a level from which we could then see a correction of 5% to 10%. Our longer-term target remains 2,200 or above. In fixed-income markets, 10-year and 30-year Treasuries look fully valued, especially with growth in Europe now looking more positive. Overall, given current bond market yields and stock prices, we believe equities offer better relative value than fixed income. In terms of flows, we see support for corporate bonds, especially investment-grade, continuing for the remainder of the year.