Weekly Market Update

Little change in equity and fixed-income markets despite positive corporate earnings, economic data is mixed

WILLIAM RIEGEL, HEAD OF EQUITY INVESTMENTS

LISA BLACK, HEAD OF GLOBAL PUBLIC FIXED-INCOME MARKETS

ARTICLE HIGHLIGHTS

- U.S. Equity markets largely unchanged this week despite generally positive 2Q corporate earnings reports.
- Treasury yields were unchanged, bond fund flows remained strong.
- Upward revisions to Durable Goods and Capital Goods orders indicated a U.S. economic recovery that may be stronger than appears.
- Housing data was mixed, all eyes on whether recent rate increases have affected housing demand.
- Positive economic data from Europe.

JULY 26, 2013

After rising for more than a month, U.S. equities were mostly flat as the S&P 500 Index was unchanged for the week while the Russell 2000 small cap index declined a mere 0.2%. Stocks initially rallied on an increase in durable goods orders, then declined on data that showed a drop in existing home sales. U.S. equity markets have been digesting second quarter earnings reports that have been largely positive. Similarly, international equities were mostly unchanged, as measured by the MSCI EAFE Index which was up just 0.02% for the week, despite positive European economic data.

Yields on 10-year and 30-year Treasuries increased a modest six basis points (.06 of 1%) on concerns that positive manufacturing data and improving consumer sentiment, which reached the highest levels in the last six years, and is now above pre-recession levels. Both economic data points indicate a strengthening economy, which supports the odds for Fed tapering as early as September. Last week Treasury yields declined by more than 10 basis points after Federal Reserve Chairman Ben Bernanke’s testimony was interpreted to indicate that the Fed was likely to take longer than expected to modify its policy direction. Spreads on corporate bonds and non-Treasury securities narrowed modestly but generally followed the direction of Treasuries. Interestingly, fund flows into corporate and emerging-market debt mutual funds were positive last week with flows into high-yield bond funds approaching near record levels.

TIAA CREF Financial Services

Little change in equity and fixed-income markets

Economic data suggests economy is improving but "stuck in first gear"

Housing data was mixed with existing home sales down but new home sales up for the month of June.

- Durable orders increased +4.2% in June and May's reading was revised upwards to +5.2%. Revisions to previous month readings point to stronger underlying growth than the headline GDP figures suggest.
- Capital goods orders (ex-defense and aircraft) increased a modest 0.7% in June, but revisions were doubled from +1.1% to +2.2% for May, again pointing to stronger growth than initially measured.
- Unemployment claims improved modestly, moving below 3 million for the week ended July 13 from a revised 3.11 million the prior week. Although positive, unemployment remains in a sideways trend.
- Existing home sales in June dropped from May levels coming in at 5.08 million compared to 5.18 million in May. Despite this decline, existing home sales above the five million level suggests that rising interest rates have yet to materially impact housing demand.
- New-home sales were up +8.3% in June compared to +1.3% reading in May. New home sales are a better indicator for a recovery in the housing market.
- The home price index was up 0.7% in May; year-to-date home prices are up 7-10% across the U.S., which indicates solid demand for housing.

Continued improvement in the housing and labor markets remain key for continued GDP growth. We are watching housing data especially closely in the coming weeks to see any signs that the recent spike in interest rates has affected the nascent reduction in the supply of housing stock.

Positive economic data in Europe

The European PMI index for manufacturing came in at 50.1 for June, indicating a slight expansion. More importantly, the strength in manufacturing was across the continent which was viewed very positively. The European Services PMI remained in negative territory at 49.6, but also improved on the month. Spain's official unemployment rate improved for the first time in over two years with a reading of 26.26%, down from 27.16% in the first quarter. Overall, Europe remains in a recession, but recent data does continue to suggest that it has bottomed. We continue to believe that Europe as a whole will remain in recession for much of the remainder of the year, but expect to see positive growth again either in the fourth quarter or beginning of 2014.

Outlook

With stocks moving higher year-to-date, 84% of the stocks in the S&P 500 are now above their 50 day moving averages, which often indicates that a pause or short-term correction could occur. Investor sentiment is high and short term optimism has risen to a point that usually precedes corrections. However, longer term measures of sentiment are still supportive for longer term gains. Despite the potential for near term volatility, we are still constructive on U.S. equities and think the S&P 500 index could trade within a range of 1700-1800 by year end.

The biggest worry for the fixed-income markets remains the speed at which interest rates will eventually rise. In addition to the decline in bond prices as interest rates rise, a rapid rise in Treasury yields would likely cause spreads on corporate and non-Treasury bonds to widen from current levels. However, our view remains that interest rates will rise but at a gradual enough pace to avoid extreme volatility. Fewer new bond issuances following the rate increases earlier this month provides support for corporate bonds and other non-Treasury bonds. We are particularly constructive on high-yield debt as credit defaults will likely decline with an improving economy and spreads on high-yield bonds are still attractive relative to other sectors of the fixed-income market.

TIAA CREF
Financial Services

The information provided herein is as of July 26, 2013.