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Weekly Investment Commentary

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Stock prices slip, although sentiment remains positive

For the first time in nearly five months, U.S. equities experienced back-to-back weekly losses, with the S&P 500 Index declining 2.5%.[1] The weakness was due to overbought conditions (especially in technology) plus mounting skepticism over prospects for another fiscal stimulus package. Coincident with the selloff in technology, growth and momentum underperformed value and cyclicals.[1] Energy was the worst-performing sector, as oil prices fell on global demand concerns.[1]

HIGHLIGHTS

- **Stocks are now down for two weeks in a row. Given that investor sentiment remains elevated, we think additional near-term selling pressure is likely.**
- **Over the longer term, however, we continue to think that an improving economy and still-supportive monetary policy should help equity markets.**
- **We may be starting a more significant rotation away from growth and momentum and toward value and cyclicals.**

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Bob Doll serves as a leading member of the equities investing team for Nuveen, providing reasoned analysis through equity portfolio management and ongoing market commentary.

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10 observations and themes

1) The current selloff is primarily due to valuations and overbought conditions. Since we have not seen any meaningful moves in Treasury yields, the drop in equity prices does not appear to be associated with changing views about the trajectory of the economic recovery.

2) We think additional selling pressure is likely. Recent price action feels like it is part of a correction period (and, indeed, the NASDAQ Composite has dropped more than 10% from its recent high).[1] Investor optimism still appears elevated, but suggests we could see more downside pressure.

3) The jobs market is showing mixed signals. On the negative side, progress on initial jobless claims has stalled. The most recent reading of 857,000 weekly new jobless claims has held steady since mid-August.[2] On the positive side, new job openings have been rising, which suggests business confidence levels are improving.

4) If a new fiscal stimulus package fails to pass, we could see economic weakness in the fourth quarter. Fiscal stimulus has helped shore up consumer spending and kept delinquency rates and bankruptcies in check. These trends could shift if we don't see additional support.

5) Inflation may be starting to creep higher. The large 0.4% month-over-month increase in core CPI in August was primarily due to a surge in used car prices, which reflects dwindling inventories.[3] With production lagging the rebound in consumer spending, similar upward price pressures could appear elsewhere in the economy. Year-over-year core CPI is now at 1.7% and could move higher in the months ahead.[3]

6) Fed policy should remain a positive for equity markets. The exact policy trend from here is unclear, but the dovish inflation-targeting approach is a plus for stocks.

7) Investors are growing more concerned about politics and less so about the coronavirus. The latest Evercore ISI investor survey shows more people think the U.S. election is a bigger risk to markets than the coronavirus pandemic. Additionally, 74% of those surveyed expect virus death rates to fall over the coming months.

8) In fact, daily new infection rates are ticking down, even as more schools are starting to reopen. If this trend continues, it could help limit downside economic and equity market risks.

9) The U.S. election presents several possible risks. We could have uncertainty for some time about who actually wins the presidency. Even more worrisome would be a repeat of 2000, if there is a prolonged fight over who actually won. Either situation could mean many Americans would doubt the legitimacy of the outcome.

10) We could start to see a disconnect between strong consumer sentiment and falling disposable income. The former is being helped by a declining coronavirus mortality rate. The latter is being hurt by less fiscal support from Washington. This week's economic data set includes August retail sales and the University of Michigan's consumer sentiment survey, so we may get clue as to which force is stronger.

Additional caution appears warranted

After months of consistent gains, U.S. mega cap technology stocks have hit a rough patch, pulling down the broader market. Technical indicators had been looking stretched and valuations remain elevated, but the economic and policy backdrop hasn't changed recently and we have not seen widespread panic or a dip in sentiment.

While central bank policy remains extremely supportive of equities, investors should consider a number of downside risks. For one, government bond yields remain at extreme lows and have limited room to drop to provide economic or equity market relief during times of stress. Commodity markets may also be showing some cracks. Oil prices have sunk recently following their sharp rebound from the initial pandemic-induced shock, and gold and industrial metal prices appear due for a pullback. Additionally, we still think equity prices reflect a more positive corporate earnings backdrop than we think is likely.

The decline in tech stocks could prove to be a temporary blip based on an extreme run up among a handful of companies. In addition to the fundamental issues cited earlier, we also think markets could be vulnerable to growing geopolitical tensions. High on the list, of course, is uncertainty surrounding the U.S. election. But Brexit issues are also back in the headlines, and growing protectionism around the world could drag on the economy and markets.

To us, all of this suggests that we may see some additional selling pressure in the weeks and months ahead, meaning additional caution is probably wise. Risk-off phases are often associated with a shift in market leadership, and we may be at the start of better relative performance for value and cyclical areas of the market. We think such a rotation is likely, but the exact timing and degree remains elusive.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-2.5%	4.8%
Dow Jones Industrial Avg	-1.6%	-1.3%
NASDAQ Composite	-4.1%	21.8%
Russell 2000 Index	-2.5%	-9.4%
MSCI EAFE	1.5%	-4.9%
MSCI EM	-0.7%	-0.2%
Bloomberg Barclays US Agg Bond Index	0.3%	7.0%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 11 September 2020. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account. All indexes are unmanaged and unavailable for direct investment.

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1 Source: Bloomberg, Morningstar and FactSet

2 Source: Department of Labor

3 Source: Bureau of Labor Statistics

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the *Nasdaq*. The **Nasdaq Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **Russell 2000 Index** measures the performance approximately 2,000 small cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. **Euro Stoxx 50** is an index of 50 of the largest and most liquid stocks of companies in the eurozone. **FTSE 100 Index** is a capitalization-weighted index of the 100 most highly capitalized companies traded on the London Stock Exchange. **Deutsche Borse AG German Stock Index** (DAX Index) is a total return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange. **Nikkei 225 Index** is a price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange. **Hong Kong Hang Seng Index** is a free-float capitalization-weighted index of selection of companies from the Stock Exchange of Hong Kong. **Shanghai Stock Exchange Composite** is a capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. **MSCI EAFE Index** is a free float-adjusted market capitalization weighted index designed to measure developed market equity performance, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. The **BofA Merrill Lynch 3-Month U.S. Treasury Bill Index** is an unmanaged market index of U.S. Treasury securities maturing in 90 days that assumes reinvestment of all income.

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