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Weekly Investment Commentary

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# Stocks rally, but still face hurdles

*Equities rallied last week, with the S&P 500 Index up 3.8% and posting its best weekly performance in more than three months, marking its highest level since early September.[1] The rally was driven by stimulus optimism, fewer concerns around a contested election, better news around COVID-19 vaccines and therapies and several positive earnings pre-announcements. Materials and energy were best-performing sectors, while REITs and communications services were the worst.[1]*

## HIGHLIGHTS

- **Stocks rallied last week, with the S&P 500 posting its best performance in three months.**
- **Speculation is increasing that Joe Biden will win the presidency, and Democrats could win the Senate and retain the House, but a Democratic sweep would have a mixed effect on stocks.**
- **Investors remain optimistic that the rise in coronavirus cases will not materially impact the recovery, but a medical breakthrough is needed for equity markets to move higher.**


**Robert C. Doll, CFA**
*Senior Portfolio Manager and Chief Equity Strategist*


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.

## 10 observations and themes

**1) U.S. and global economies experienced v-shaped rebounds coming out of the coronavirus shut downs** due to massive stimulus. But growth rates have started to moderate, as reflected by PMIs and other economic statistics. In the U.S., third-quarter real GDP likely surged more than 30%, but will shift down to less than 5% in the fourth quarter.[1]

**2) The Fed has been clamoring for more fiscal stimulus while it continues monetary stimulus.** Lower rates have spurred a housing boom, which should offset weak recoveries in many pandemic-challenged industries.

**3) We have regained 11.4 million of the 22.2 million jobs lost in March and April,** and the unemployment rate continues to decline.[2] The economy is still adding jobs, but the "easy" part of the jobs recovery is likely over.

**4) Polls show increasing chances for a Democratic blue wave,** but such a result will have mixed effects on stocks: corporate tax rates would rise, but markets would welcome improved trade relations with China and a push for more stimulus.

**5) A Democratic sweep is likely to reduce the after-tax return of owning stocks,** eventually putting downward pressure on stock prices. An increased corporate rate to 28%would decrease corporate profits 10% to 15%. If dividend and capital gains rates go from 23.8% to 43.4%, corporate profits must rise nearly 50% to maintain the after-tax rate of return of stock ownership.

**6) Merger activity has picked up ahead of the election,** given the possibility of higher capital gains taxes and stricter antitrust reviews under a Biden presidency.

**7) Many market sectors are anticipating a Biden victory.** For example, renewable and clean energy stocks have outperformed significantly year to date, implying that the group is vulnerable to profit-taking if Trump is reelected.

**8) U.S. Treasury yields have risen 15 basis points across the curve in the last several days.** Reasons include: failure to agree on another round of stimulus, rising inflation expectations, increased magnitude of Treasury auctions and anticipation of the blue wave and more federal spending.

**9) International, value and cyclical stocks require several factors to outperform U.S., growth and defensive stocks consistently**: greater visibility on economic growth, a fiscal stimulus package, vaccine development and a weaker dollar.

**10) The aftermath of the great recession highlighted the dangers of enacting premature fiscal austerity.** While we expect the U.S. economy to continue to recover post coronavirus, neither the household nor the business sector is healthy enough to offset any drag from the government sector. The U.S. will need a fiscal cleanup over the next several years, but success will hinge first and foremost upon ensuring solid private sector growth.

## A choppy path ahead for the global economy

We continue to expect the path forward to be more gradual and choppy. Greater social mobility still generates a surge in infections. The scientific community has made great strides, but permanent layoffs are growing and the global economy has not achieved a self-reinforcing expansion. Despite massive monetary support, equity markets will struggle to move higher absent a medical breakthrough.

Additional sources of economic and capital market uncertainty remain. The U.S. political backdrop will remain volatile until the election. With fiscal stimulus negotiations ending, additional business failures and layoffs may occur. Brexit remains a considerable source of economic uncertainty for Europe, and other geopolitical and trade tensions persist. We will watch to see if the policy-created reflationary bridge will hold until economic activity becomes self-reinforcing. The path of the pandemic will largely determine the outcome.

Equity markets remain optimistic that the rise in coronavirus cases will not materially impact the recovery, with most markets and sectors consolidating rather than retreating. In terms of the U.S. economy, the critical consumer sector remains caught between hopes for a medical breakthrough and a return to normal mobility, at the same time job security and layoffs are deteriorating. The longer restrictions on economic activity and non-normal mobility persist, the greater the odds of more permanent layoffs and tepid consumption. Similar trends are occurring around the world, reinforcing the threat to equity markets. Hyper-accommodative monetary conditions and hopes for better profits down the road have propped up equity markets, but they are no longer able to generate forward motion. A medical breakthrough is needed to end this holding pattern.

### 2020 PERFORMANCE YEAR TO DATE

| | Returns | |
|---|---|---|
| | **Weekly** | **YTD** |
| S&P 500 | 3.9% | 9.2% |
| Dow Jones Industrial Avg | 3.3% | 2.0% |
| NASDAQ Composite | 4.6% | 30.0% |
| Russell 2000 Index | 6.4% | -0.8% |
| MSCI EAFE | 3.0% | -3.9% |
| MSCI EM | 3.8% | 2.9% |
| Bloomberg Barclays US Agg Bond Index | -0.2% | 6.6% |
| BofA Merrill Lynch 3-mo T-bill | 0.0% | 0.6% |

Source: Morningstar Direct, Bloomberg and FactSet as of 9 Oct 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.

*"Equity markets remain optimistic that the rise in coronavirus cases will not materially impact the recovery."*

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1 Source: Bloomberg, Morningstar and FactSet

2 Source: Department of Labor

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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