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The economy and financial markets need a medical breakthrough

Stocks sold off sharply last week, experiencing their worst week since the beginning of the coronavirus crisis in March. Investors reacted negatively to news of increasing cases in the U.S. and Europe, fading hopes for near-term fiscal stimulus and growing election-related uncertainties. All sectors were down for the week, with the worst declines in industrials, technology and consumer discretionary.

HIGHLIGHTS

- **The near-term risks we have been talking about for months may have finally caught up with financial markets.**
- **Looking ahead, we think stock prices will be driven by coronavirus news and more uneven economic data than we saw in the earlier part of the expansion. This could create additional headwinds for equities.**
- **Over the longer term, however, we think a new fiscal stimulus package early next year and an eventual effective vaccine will create a path for improving stock prices.**



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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.

10 observations and themes

1) New waves of coronavirus cases are likely to negatively impact economic growth. We are already seeing reversals of reopening efforts throughout Europe. And rising caseloads in the U.S. are starting to limit economic activity. The only silver lining is that mortality rates have been falling. We expect medical advancements will allow for more economic activity over the course of 2021.

2) The economic recovery will likely tail off in the coming months. While the third quarter annualized GDP increase of 33.1% is impressive, the U.S. economy is still 3.5% smaller than at the end of 2019. And with coronavirus cases rising sharply and scant prospects for new fiscal stimulus before next year, further economic progress will likely be limited. At this point, we expect fourth quarter GDP up only around 4%.

3) Strong consumer confidence remains an economic bright spot. Personal income and consumption spending in September were both stronger than expected. And the savings level dipped as well, showing people are still willing to spend.

4) In response to slowing growth and rising virus caseloads, the European Central Bank is likely to engage in additional easing in December. This would put further downward pressure on the euro.

5) Corporate earnings have been much better (meaning less worse) than expected. With three quarters of S&P 500 companies reporting, 80% have beaten expectations by an average of nearly 20%. At this point, earnings are on track to only be down 11% for the quarter.

6) We could see a fiscal stimulus package shortly after the election, but chances are greater for early 2021. The size and scope of any new spending package will be driven by election results. If we see something sooner rather than later, it would likely be a smaller and more limited spending bill, such as the \$500 billion package that Senate Republicans passed.

7) We think Treasury yields will continue to inch higher. The 10-year yield rose 20 basis points in October on expectations of better growth and a sizable fiscal stimulus package next year, as well as indications of modest inflation and a huge supply of Treasury issues. We think these factors could push rates toward 1% by the end of this year and higher in 2021.

8) It seems more likely that taxes will increase next year. If current polls hold true, Joe Biden will win the presidency and the Democrats will take over the Senate. Should that happen, we expect tax rates to rise notably and regulatory scrutiny to increase. This would likely create headwinds for stocks in the coming years.

9) A more uneven economy could trip up stock prices. The recovery is moving from its earlier V-shape to something more choppy. We expect the economy to continue growing in the coming quarters, but a less strong acceleration presents risks to equity markets.

10) The long-term outlook for stocks is more positive than the short term. Over the next few months, market action is likely to be dominated by ongoing spikes in virus cases and uneven economic data. We continue to believe that a vaccine and successful medical treatments are necessary for the economy to enter a self-sustaining expansion. When that happens, it should create a better environment for stocks.

Stocks continue to face near-term pressure

Since the recovery started, we have been concerned that investors were overly optimistic. Markets have rebounded strongly since the spring on hopes of medical advancements, ongoing monetary and fiscal stimulus and a return to stronger economic conditions. In contrast, investors generally ignored bad news such as signs that the virus was spreading, areas of the global economy (particularly in Europe) would shut down and additional fiscal stimulus was less likely. At the same time, markets had been advancing in the run up to the election, as most were looking past the prospects of a contested result or some longer-term negatives like prospects for higher taxes.

Over the last week, these concerns may finally have caught up to stocks, triggering a sharp selloff. Now, markets could overreact to the downside. Over the short-term, markets will likely be driven by the pandemic and the outcome of the U.S. elections. Regarding the former, a full return to normal economic activity clearly won't happen without a vaccine and more effective treatments. Even if governments and policymakers don't enact new lockdowns, many individuals and businesses will continue to impose restrictions. And for the latter, we should (hopefully) get some clarity this week so we can better gauge the financial impact of the election results.

In any case, the economic recovery is clearly slowing, but we do see better conditions on the horizon. The "easy" part of the recovery seems to be over, and we expect choppy economic data from here. The odds are high that we'll see a sizable new fiscal stimulus package early next year, regardless of the election outcome. And we hope that medical advancements will spark more economic activity in the months ahead. While we expect more near-term economic and market turbulence, we think stock prices should climb over the next six to twelve months.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	-5.6%	2.7%
Dow Jones Industrial Avg	-6.5%	-5.4%
NASDAQ Composite	-5.5%	22.5%
Russell 2000 Index	-6.2%	-6.8%
MSCI EAFE	-5.5%	-10.4%
MSCI EM	-2.9%	1.2%
Bloomberg Barclays US Agg Bond Index	0.0%	6.3%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 30 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.

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Sources

All market data from Bloomberg, Morningstar and FactSet
Economic growth data from the Bureau of Economic Analysis
Earnings data from Credit Suisse Research

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