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We may be seeing a shift toward cyclical and value styles

Global stock markets enjoyed a third week of gains, as global monetary policy continued to ease and as trade tensions lessened (or at least did not get worse).¹ The European Central Bank ramped up its easing policies and the Federal Reserve looks set to cut rates this week, which helped the overall risk-on sentiment. In the U.S., the S&P 500 Index rose 1.0%, with small caps, value styles and cyclical areas enjoying the strongest gains.¹ Treasuries came under pressure again and have given back most of the August gains.¹

HIGHLIGHTS

- **The risk-on sentiment continued to grow as stock prices rose for a third week. At the same time, we have seen a sharp shift toward more cyclical and value styles. This trend could have more room to run.**
- **We expect the Fed will cut interest rates this week, but then may adopt a wait-and-see approach, especially as recession risks appear to be fading slightly.**



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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.

Weekly top themes

1

Inflation is rising slightly, complicating the Fed's easing stance.

The core Consumer Price Index rose 0.3% in August for an annualized increase of 3.4%.² The index has now experienced its strongest three-month advance since September 2008.² Inflation data shouldn't affect the Fed's actions this week, but do cast some doubt as to the future direction of interest rate policy.

2

U.S./China trade negotiations are continuing, but we haven't seen changes in the fundamental disagreements.

The parties will likely separate trade issues from national security issues during the October negotiations, which should help talks progress. Ongoing dialogue is a good thing, but we still see little chance of a comprehensive deal. It is possible we could see gradual progress such as an agreement by China to purchase U.S. agricultural goods in exchange for additional delays in tariffs.

3

The regulatory backdrop could change notably after the 2020 elections.

By any measure, the regulatory backdrop under the Trump administration has been much more lax, and thus business friendly, than it was over the previous eight years. Should Democrats retake the White House, that positioning will likely change.

4

There has been a clear shift toward risk-on positioning over the past few weeks.

We would cite several causes, including some better economic data, an easing of trade tensions, de-escalation in Hong Kong, receding risks of a hard Brexit and an easier monetary policy backdrop.

5

This shift has also caused a change in equity market leadership.

We have seen a massive rotation away from momentum, growth styles, defensive stocks and higher quality to value, smaller caps and cyclical areas of the market. It is too early to say whether this shift is a blip or the start of a prolonged leadership change. If economic sentiment continues to improve, and especially if we see a recovery in manufacturing data, we would be more inclined to believe it is the latter.

Recession fears appear to have peaked

Global bond yields were plummeting a few weeks ago, with U.S. Treasuries falling sharply and other government bond markets trading further into negative territory. That trend has reversed sharply over the past two weeks, with the 10-year Treasury yield rising nearly 50 basis points.¹ In retrospect, it seems clear that bond markets were forecasting too high a risk of recession.

In our view, markets, investors and policymakers may be paying too much attention to trade and manufacturing data. These areas of the economy are important, but have been providing much more negative signals than the labor market, consumer spending and the service sector, which have all been solid. We don't think recession fears will ease significantly until and unless we see a rebound in manufacturing, but bond markets are starting to reflect a more realistic economic outcome. We think yields will continue to move erratically, but could still see some additional near-term upward pressure.

Against this backdrop, the Fed will almost certainly cut rates by an additional 25 basis points this week, but forward guidance will be critical. The Fed seems to recognize that it overstepped on rate hikes in 2018, and we think the central bank will be careful not to do the same on cuts this year. We don't think the Fed will bow to political pressure from the White House, but will probably remain cautious and data-dependent. We wouldn't be surprised to see Fed Chair Powell signal the probability of a wait-and-see approach, and the Fed could stand pat for a while if economic sentiment continues to improve.

2019 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	1.0%	21.7%
Dow Jones Industrial Avg	1.7%	18.8%
NASDAQ Composite	0.9%	24.2%
Russell 2000 Index	4.9%	18.2%
Euro Stoxx 50	2.0%	18.1%
FTSE 100 (UK)	2.6%	11.0%
DAX (Germany)	2.7%	14.3%
Nikkei 225 (Japan)	2.5%	13.6%
Hang Seng (Hong Kong)	2.8%	9.4%
Shanghai Stock Exchange Composite (China)	1.6%	21.0%
MSCI EAFE	2.0%	14.8%
MSCI EM	1.9%	8.8%
Barclays US Agg Bond Index	-1.7%	7.1%
BofA Merrill Lynch 3-mo T-bill	0.0%	1.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 13 Sept 2019. 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: FactSet, Morningstar Direct and Bloomberg

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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