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Weekly Investment Commentary

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Global economic growth should pick up a notch

Stock prices sank on a holiday-shortened week, despite some continued decent news on the economic and corporate earnings fronts. Anxiety about the growing coronavirus scare appears to have hurt markets, and investors also seemed to be in the mood for some profit-taking. The S&P 500 Index fell 1.0% last week, with the bulk of the decline coming on Friday, when the index experienced its worst day since October.[1] The only sectors to finish in the black were utilities, REITs and technology.[1] Energy, materials and financials led the way to the downside.[1]

HIGHLIGHTS

- **Global economic growth appears to be improving modestly. And the corporate earnings backdrop should remain relatively solid this year.**
- **At the same time, some big risks that topped the list of worries for investors over the past several years (chiefly trade) have been fading.**
- **This presents a good backdrop for equities, but we think valuations appear full, meaning markets may need to experience a consolidation phase before again moving higher.**

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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 themes covering the economy, markets and the political backdrop

1) An improving housing market augers well for the U.S. economy. Housing starts climbed a higher-than-expected 16.9% in December, while existing home sales rose 3.6%, the strongest advance since February 2018.[2] Importantly, the United States has never fallen into recession while housing was on an uptrend.[1]

2) Improving European manufacturing levels also suggest the global economy could be on sounder footing. Recent UK and eurozone purchasing manager index readings have been better than expected, an important signal for European growth.[3]

3) The usual signs that signal the end of an economic expansion don't appear present. In our experience, this list would include investors becoming overly optimistic, oil prices rising, inflation accelerating, central banks tightening and the yield curve inverting. Not much of that seems to be the case today.

4) Fourth quarter corporate earnings results have been solid. With 21% of S&P 500 companies reporting, earnings are ahead of expectations by an average of 5.1%, with 58% of companies exceeding bottom-line expectations.[4] Earnings-per-share are on trend to rise by 3% for the quarter.[4]

5) In all, we think the economic and corporate environment is improving. Inflation remains low, which has helped keep interest rates lower and equity valuations higher. Both trends are important drivers of broader economic growth and corporate health. At the same time, the consumer sector and labor markets are strong, monetary policy remains easy, the corporate regulatory backdrop is very accommodative and lower corporate tax rates have been fueling growth.

6) The strength of the U.S. dollar versus the Chinese yuan will be an important metric to watch. The dollar began weakening relative to the yuan once trade negotiations began in earnest and accelerated as we got closer to the phase-one trade deal.[1] Should trade tensions continue to ease, the value of the dollar could continue to fall.

7) The pharmaceutical and biotechnology industries are likely to remain volatile. Prices for these sectors took a hit on Friday over worries that Washington may be taking action to put a lid on drug prices. We don't expect meaningful legislation before the election. But given the popularity of this issue, Democratic candidates will likely continue focusing on it, which may continue to rattle the markets.

8) The current economic backdrop should be a plus for President Trump's reelection prospects. Last year's interest rate cuts and the resolution of some thorny trade issues have reduced prospects for a near-term recession.

9) A number of political and policy risks could negatively affect equity markets in 2020. Strategas Research recently pointed to some with which we agree: a strong showing by more progressive Democrats in the early primaries; a possible unravelling of the U.S./China trade deal that sparks more trade disputes; the impeachment proceedings drag on longer than expected; the Federal Reserve turns more hawkish; President Trump adopts more populist positions on drug pricing and tech privacy issues; Democrats win the White House and take over the Senate; or any of a number of possible geopolitical flare-ups around the world.[5]

10) Despite all of the good news, we think it is hard to make a case to get aggressive on equity positioning. In our view, the rise in prices over the past year, combined with modest earnings growth, means that market valuations are probably full and possibly extended in some areas.

Risks have receded, but equity valuations still look full

Over the past several months, the global equity rally has been broadening as expanding liquidity, slowly improving world growth, still-low bond yields and accommodative monetary policy have led to improving investor sentiment. Non-U.S. stocks continue to lag their U.S. counterparts on a long-term cyclical basis, but non-U.S. markets have been catching up as investors appear more comfortable with risk-taking.

Many issues holding investors back over the past several years appear to have faded. The chief risk of the last couple of years has been trade policy uncertainty. But the recent U.S./China phase-one trade deal and the ratification of the USMCA has removed much of that uncertainty. Outside of worries about the coronavirus outbreak, the only real new risk emerging in recent weeks is a growing sense that global financial markets may be stretched.

We are watching closely the potential for a rise in bond yields. Since the current economic cycle began, bond yields have been quick to fall on any hint of rising recession risks, but slow to rise on prospects for improving economic growth. We think we may be approaching an inflection point where improving global economic growth and better investor sentiment could push bond yields higher. Should that happen, it could create a headwind for stocks and other risk assets.

For now, we think the global economy appears to be moving toward a more solid footing than it experienced over the past couple of years. Expectations for corporate earnings may be too high, but we still expect growth to be positive in 2020. Nevertheless, we believe the extremely sharp rise in equity prices over the past 12 months has pushed stocks to being fully valued. We think markets are due for a consolidation or digestion phase in the near term, which should help reduce that risk factor.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-1.0%	2.1%
Dow Jones Industrial Avg	-1.2%	1.7%
NASDAQ Composite	-0.8%	3.8%
Russell 2000 Index	-2.2%	-0.3%
Euro Stoxx 50	-1.3%	-0.7%
FTSE 100 (UK)	-0.7%	-0.8%
DAX (Germany)	-0.2%	0.8%
Nikkei 225 (Japan)	-0.2%	0.3%
Hang Seng (Hong Kong)	-3.9%	-0.6%
Shanghai Stock Exchange Composite (China)	-3.8%	-1.6%
MSCI EAFE	-0.6%	0.4%
MSCI EM	-2.4%	0.5%
Bloomberg Barclays US Agg Bond Index	0.8%	1.3%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.1%

Source: Morningstar Direct, Bloomberg and FactSet as of 24 Jan 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.

The extremely sharp rise in equity prices over the past 12 months has pushed stocks to being fully valued."

For more information or to subscribe, please visit nuveen.com.

1 Source: Bloomberg, Morningstar Direct and FactSet

2 Source: Department of Commerce

3 Source: Markit Economics

4 Source: Credit Suisse Research

5 Source: Strategas Research, *What Policy Issues Can Slow the Current Equity Market Rally*, January 21, 2020

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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