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Weekly Investment Commentary

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Economic growth should eventually show signs of improvement

Equity markets continued to rise last week, as investors began to look past coronavirus-related fears. In our view, the economic damage caused by the coronavirus could be significant in isolated areas but it should be relatively temporary and hopefully well contained. We see no signs that the 10+ year economic expansion or equity bull market are likely to end, although we think valuations look stretched, which presents near-term risks.

HIGHLIGHTS

- **Following a coronavirus-related setback in January, stock prices are moving higher as investors have looked past the economic damage.**
- **Corporate earnings expectations for 2020 have been declining, but still suggest healthy earnings growth.**
- **We expect the current economic expansion and equity bull market to persist, but valuations may be stretched in the near-term.**

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.

Coronavirus economic damage should be relatively contained

Markets dropped sharply in January on economic fears associated with the spread of the coronavirus, but have since recovered. Most investors seem to believe that the economic hit will be short-lived and the damage will not derail the broader global economic expansion.

We expect the Chinese economy could suffer significantly in the short term, but the global and U.S. economies should be fairly well insulated. From a markets perspective, Chinese stocks and other stocks closely associated with China have taken the hardest hit with the slowest recovery.

Time will tell how much the global economy will be affected by damage to Chinese consumption, services and manufacturing. A manufacturing shortfall in particular could be a risk and could trigger a contagion. Some global manufacturing data will be released this Friday, and we may see some downturns. Over time, however, we think the broad effects should eventually fade.

The Fed is likely to remain accommodative

At the start of the year, it was an open question as to what, if any, action the Federal Reserve would take in 2020. Economic growth was picking up, wage growth was climbing slowly and we saw upward pressure on prices. In such an environment, the Fed may have indicated potential tightening of monetary policy (although it would be hard to imagine the Fed raising rates in the run up to the November elections).

Given the economic fears associated with the coronavirus, we now think there is very little chance the Fed will increase rates this year. The Fed has clearly shown it will tolerate higher inflation if and when economic growth picks up again.

Some are calling for additional Fed rate cuts, which we think remains unlikely. The bottom line for investors: we see no indications of a policy shift any time soon. With rates remaining low, the economy and stock market could continue to enjoy the tailwinds from accommodative monetary policy.

We see no near-term signs of a recession or bear market

Over the past couple of years, the ongoing equity bull market has survived a number of threats, including rising protectionism in the form of increased tariffs, an increase in isolationism within the United States, a messy Brexit situation, rising tensions in the Middle East and on the Korean peninsula, a contraction in manufacturing, rising U.S. political uncertainty in the form of the impeachment proceedings and the 2020 elections and periodic jumps in bond yields. But none of these risks has derailed equity markets for long.

Solid economic growth and accommodative policy have helped the economy and stock market to remain resilient. And, in fact, economic growth conditions were improving before the onset of the coronavirus.

At this point, the U.S. economy appears to be holding steady, despite downward pressures to manufacturing and trade. The labor market remains strong, which is supporting high consumer spending levels and promoting broader economic growth.

A closer look at the jobs market shows some companies (especially small businesses) struggling to find high-quality employees as the participation rate is rising, which could hamper productivity and profit margins.

However, we see no near-term catalysts for a recession, and expect the ongoing equity bull market to continue.

Equity markets may be overdue for a pullback

Throughout 2019, we were concerned that 2020 corporate earnings expectations may have been too high. Fourth quarter earnings reports have been fairly well received, thanks in large part to falling expectations at the end of last year and into 2020.

At the same time, forward guidance from corporate management teams has been cautious, further reducing expectations for 2020 results. In general, revenue growth has kept up with economic growth, but profit margins remain under modest pressure.

Despite solid longer-term prospects, we think the equity market is overdue for a pullback or consolidation phase. By our reckoning, technical conditions are stretched following the huge advance in prices over the past six months. And we also think current prices reflect improvements in economic growth and corporate earnings.

To experience an ongoing rally, stocks would require a stronger acceleration in the economy and corporate earnings than we think is likely. Thus, we expect markets will be choppy and uneven over the course of the coming year.

This creates a complicated environment for investors. Amid relatively high levels of uncertainty, most investors have been sticking with and doubling down on areas of the market that outperformed in 2019, such as U.S. growth stocks.

If and when the economy shows it is set to resume its acceleration, this relative performance is likely to shift, which could benefit value and cyclical areas. But the timing of such a move is highly uncertain.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	1.7%	4.9%
Dow Jones Industrial Avg	1.2%	3.3%
NASDAQ Composite	2.2%	8.6%
Russell 2000 Index	1.9%	1.3%
Euro Stoxx 50	0.2%	-0.7%
FTSE 100 (UK)	0.6%	-3.1%
DAX (Germany)	0.8%	0.3%
Nikkei 225 (Japan)	-0.5%	-0.6%
Hang Seng (Hong Kong)	1.5%	-1.0%
Shanghai Stock Exchange Composite (China)	1.7%	-4.7%
MSCI EAFE	0.0%	-0.3%
MSCI EM	1.4%	-0.7%
Bloomberg Barclays US Agg Bond Index	0.0%	1.9%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.2%

Source: Morningstar Direct, Bloomberg and FactSet as of 14 Feb 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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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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