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Weekly Investment Commentary

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Stocks rebound after sharp slide

U.S. equities rebounded last week, with the S&P 500 Index gaining 1.9%.[1] We can trace the recovery to many factors: relief from overbought conditions thanks to last week's pullback, the Federal Reserve's announcement that it would buy individual corporate bonds, renewed speculation about infrastructure stimulus and V-shaped recovery expectations following better-than-expected May retail sales. Health care and technology were the best-performing sectors, while utilities lagged.[1]

HIGHLIGHTS

- **Stocks bounced back due to many factors, including strong retail sales.**
- **The Federal Reserve announced that it would continue to support credit markets, also boosting sentiment.**
- **A return to normal economic activity and behavior is not yet on the horizon, so we urge investors to be patient.**

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) The depth of the economic plunge has been milder than anticipated, while the subsequent rebound has been stronger than expected. May U.S. retail spending increased 17.7% month-over-month, marking the largest monthly increase on record.[2] This, along with the strong May employment and industrial production reports, strongly suggest we reached the bottom of the recession in April.

2) Second quarter GDP may have fallen by "only" 30% to 35%, versus the originally anticipated 40%. Third quarter GDP could increase 10% to 20%. However, Congress's failure to agree on a phase-four fiscal package, and/or a sharp acceleration of new virus cases, would put that projection at risk. If a vaccine becomes widely available as soon as early 2021, growth would likely increase more as the remaining physical constraints and risks abate.

3) Just as March and April were worst months of 2020, May, June and July should be the strongest. We are concerned that growth will slow, but should remain positive past the summer recovery.

4) Fed Chair Powell broadly encouraged more Congressional action to support the economy. Given the uncertainty in the recovery, he highlighted the need for continued unemployment support and state budget issues as appropriate areas for relief.

5) We believe Congress will pass another round of fiscal stimulus this summer, with significant increases in state and local government aid, some liability protection for corporations, further unemployment insurance aid and some paycheck protection support for small businesses. Any significant increase in infrastructure spending seems unlikely.

6) Small businesses have been disproportionately hit by the effects of the coronavirus pandemic. Small businesses are typically more financially fragile than their larger competitors and their access to credit is more difficult.

7) The collapse of global tax negotiations has increased the likelihood of another trade war. European nations may impose new taxes on U.S. tech companies, which in turn will prompt additional tariffs from the U.S. on a wide range of European goods.

8) International sales now comprise 29% of S&P 500 revenues, according to Goldman Sachs, marking the lowest level in 10 years. This is a result of faster growth in U.S. sales over the last decade compared with non-U.S. sales, meaning the S&P 500 is not the global index it once was.

9) Joe Biden became even more favored to win the White House in the past week. Betting markets are also starting to believe the Senate will flip to the Democrats. According to the research group Cornerstone Macro, the Biden agenda would impose $3.5 trillion in net new costs on businesses and investors by increasing the corporate tax rate from 21% to 28% and taxing capital gains and dividends at ordinary rates for high-income Americans.

10) The equity-risk premium increased this year, but heightened policy uncertainty will continue, likely resulting in little price movement for stocks over the summer. Civil unrest is rising, Korea is heating up and China and India are increasingly at odds. Investors largely ignored these factors when financial liquidity was quickly expanding. While liquidity should remain plentiful, it will begin to decelerate. Eventually, the level of political risk will be harder to overlook and obstacles to a continued market rally would increase.

Improved economic indicators buoy sentiment, but patience is warranted

Equity markets have started to churn after a near non-stop advance since March 23. Unprecedented central bank policies are directly benefiting credit markets with massive economic and financial asset support. Improvement in most economic indicators has buoyed investor sentiment, even if activity levels remain low. However, on the downside, the economic reopening is triggering more infections in some localized areas. Politicians still generally favor pushing ahead, so a return to widespread and lasting lockdowns is very unlikely.

Nevertheless, a return to normal economic activity and behavior does not yet seem imminent. While economic activity is improving from very low levels, it will take some time to close the gap from depressed levels. Equity markets face a long road back to pre-coronavirus profit levels. Depressed borrowing rates will support stocks, but are insufficient to justify higher prices for expensive stocks without a significant increase in long-term profits.

While prospects are decent for an eventual rotation out of U.S. equities and the U.S. dollar, we don't yet see the catalyst for better global growth needed to sustain such a move. Despite the U.S. market's high valuation, it has a less cyclical nature and a better underlying earnings profile than its global counterparts. As such, we suggest maintaining an overweight stance within a global portfolio.

We remain fairly neutral on equities and expect a churning phase or modest correction in the near term, given the sharp rebound in prices and the likelihood that corporate profits will return, although not to record levels any time soon. The keys to sustaining the uptrend in equity prices include steady improvement in employment conditions and confidence in consumer spending. As one would expect, both conditions likely require a vaccine or successful treatment.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	1.9%	-3.2%
Dow Jones Industrial Avg	1.1%	-8.2%
NASDAQ Composite	3.7%	11.4%
Russell 2000 Index	2.3%	-14.4%
MSCI EAFE	2.1%	-10.0%
MSCI EM	1.6%	-9.3%
Bloomberg Barclays US Agg Bond Index	0.2%	5.9%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 19 Jun 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 face a long road back to pre-coronavirus profit levels."*

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1 Source: Bloomberg, Morningstar and FactSet

2 Source: Commerce Department

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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