

10 PREDICTIONS FOR 2020: MIDYEAR UPDATE

Improving conditions but growing risks

A look at our old and new predictions

In January, we offered our usual annual set of 10 Predictions that were based on our premise that the economic expansion was getting long in the tooth but still had some life left. The coronavirus pandemic changed everything. Amid the height of a new bear market and sharp recession in April, we recast our predictions to provide investors with some new perspective about where things might be heading. We're going to continue keeping track of (and scoring) both our original and newer predictions through the rest of 2020. At this point, we think conditions will continue improving, but we are also growing more concerned about rising market risks.



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A long and uneven recovery

THE RECESSION WAS LESS SEVERE AND THE RECOVERY HAS (SO FAR) BEEN QUICKER THAN MANY EXPECTED.

There is no doubt that the economic downturn was incredibly deep and painful. According to the IMF, U.S. GDP is expected to fall 8% and global GDP 5% in 2020. But the recession looks like it may be less severe than what was expected in late March and early April. The bottom line: We think the recession has already ended. April appears to have been the low point for economic data, and we started seeing a recovery begin in May. So far, the recovery has looked like a “V-bottom,” but we think that will trail off and we expect a slow and uneven recovery worldwide. We think we may not get back to expansion mode until late 2021 or early 2022.

A STALLING LABOR MARKET COULD HAMPER GROWTH GOING FORWARD. The jobs market is one of the most visible and critical elements of economic data. Unemployment failed to reach the 20% level that many had been forecasting, but it is still higher than the peak reached during the global financial crisis.¹ We expect unemployment will slowly decline, but remain in the double-digit range for at least a few more months. Likewise, wage growth looks problematic. The official numbers show an increase, but that data is skewed because unemployment rose disproportionately for lower-income workers. In reality, individual wages are declining.

THE POWER OF MONETARY POLICY IS LIKELY TO WANE.

Central banks, led by the Federal Reserve, have accelerated monetary policy at an unprecedented rate, which has been great news for the economy and risk assets. And although central banks are continuing to ease, the bad news is that policy is no longer accelerating and has become about as accommodative as it can. Investors easily ignore market negatives and risks when policy is quickly moving in a positive direction, but that’s harder to do when it is not.

THE BIG QUESTION FOR THE FUTURE: HOW WILL WE PAY FOR ALL OF THIS STIMULUS?

In addition to massive monetary policy support, the U.S. has already increased federal spending by \$2.9 trillion since the pandemic began, and it looks like more is still on the way. Other countries have engaged in similarly large spending initiatives. For now, the world remains in a deflationary environment, but at some point (probably late next year and into 2022), we’ll all need to figure out how to pay for this stimulus. Options include settling for a long-term slower rate of growth, raising taxes or expanding the money supply to generate inflation and depress the value of the dollar. We’ll probably see some sort of a combination of all three approaches, with specifics depending on the results of the November elections.

KEY INDEX PERFORMANCE

TOTAL RETURNS	2Q20	YTD
S&P 500 Index	20.5%	-3.1%
Dow Jones Industrial Average	18.5%	-8.4%
NASDAQ Composite	31.0%	12.7%
Russell 2000 Index	25.4%	-13.0%
Euro Stoxx 50	20.7%	-11.9%
FTSE 100 (UK)	9.4%	-22.3%
DAX (Germany)	27.0%	-6.8%
Nikkei 225 (Japan)	17.9%	-3.8%
Hang Seng Index (Hong Kong)	5.1%	-11.4%
Shanghai Stock Exchange Composite (China)	10.0%	-2.4%
MSCI World Index (ex U.S.)	15.6%	-11.2%
MSCI Emerging Markets Index	18.2%	-9.7%
Bloomberg Barclays U.S. Aggregate Bond Index	2.9%	6.1%
BofA Merrill Lynch 3-Month Treasury Bill (Cash)	0.0%	0.6%

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

OUTLOOK

Stocks could churn through the summer

THE SPEED AND MAGNITUDE OF THE MARKET COMEBACK HAS BEEN SHOCKING.

After the quickest onset of a bear market in recent memory, stocks came roaring back in April and May before encountering more sluggishness and volatility in June. The recovery was enough to push the S&P 500 Index up 20.5% for the quarter, marking the best three-month period since the end of 1998.² In our view, the strength of the recovery can be attributed to the fact that an exogenous shock drove markets down rather than fundamental economic or financial weakness. Additionally, the massive and unprecedented monetary and fiscal stimulus helped stabilize markets and provide a strong tailwind.

OVER THE SHORT TERM, WE THINK INVESTORS WILL START TO FOCUS MORE ON THE NEGATIVES.

This trend has already started to happen over the past few weeks as investors have been focusing on the likelihood of a more uneven economic recovery, fuller stock valuations, rising numbers of coronavirus cases and a highly uncertain global and U.S. political backdrop. For now, we think the positives and negatives are roughly balanced and expect stocks will remain volatile and churn throughout the summer. We forecast a trading range of somewhere between 2,750 and 3,150 for the S&P 500 for the next few months.

ONE YEAR FROM NOW, HOWEVER, WE THINK STOCK PRICES WILL BE HIGHER THAN THEY ARE TODAY.

Assuming the economy continues to recover, even if slowly, earnings should start to grind higher by the end of the year and into the first part of 2021. Likewise, we expect improving growth to put modest upward pressure on interest rates. All of this should lead to a marginally stronger stock market.

THIS IS NOT GOING TO BE AN EASY INVESTING ENVIRONMENT, AND OUR OUTLOOK SUGGESTS SELECTIVITY WILL BE INCREASINGLY IMPORTANT.




Investors should focus on selectivity, be nimble and flexible and rely on diligent research to uncover opportunities. In particular, we think it makes sense to focus on areas of the equity market that have not yet fully priced in the effects of the current and pending global economic recovery. Regarding specifics, cyclical areas of the market look more attractive than defensive ones. From a sector perspective, we favor technology and health care, and expect the relative cheapness and reasonable quality of the financial sector could also make that area attractive. Additionally, we expect non-U.S. stocks to start outperforming on a relative basis later this year, especially if we see continued weakness in the U.S. dollar. And across all sectors and styles, we favor companies that have high levels of free cash flow and management teams who can be creative in deploying that cash and positioning for a post-coronavirus world.

EQUITY SECTORS

TOTAL RETURNS	2Q20	YTD
Communication services	20.0%	-0.3%
Consumer discretionary	32.9%	7.2%
Consumer staples	8.1%	-5.7%
Energy	30.5%	-35.3%
Financials	12.2%	-23.6%
Health care	13.6%	-0.8%
Industrials	17.0%	-14.6%
Information technology	30.5%	15.0%
Materials	26.0%	-6.9%
REITs	13.2%	-8.5%
Utilities	2.7%	-11.4%

Source: Morningstar Direct, Bloomberg and FactSet as of 30 Jun 2020. Equity Sectors are classified using the Global Industry Classification Standards (GICS) based on the S&P 500. 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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SCORECARD	
Overall Scoring	
	HEADING IN THE RIGHT DIRECTION
	TOO EARLY TO CALL
	HEADING IN THE WRONG DIRECTION

A light at the end of a very long tunnel

At the start of the year, we expected economic growth to pick up modestly, and were encouraged by seemingly diminishing macro risks, such as trade policy. Conversely, we were concerned by relatively full stock valuations, and thought that market gains could be limited following a strong 2019. The unanticipated coronavirus pandemic and resulting economic and market upheaval threw all of this for a loop. The (mostly) new predictions we offered in April were predicated on our expectation that the crisis would peak in the second quarter, paving the way for a slow economic recovery in the second half of the year. Below, we offer scoring and commentary on our full list of predictions. Whole numbers indicate our original predictions. New ones (where we made them) are indicated by an “a.”

1	The world avoids recession in 2020 as U.S. GDP grows over 2% and global GDP grows over 3%.
	

1a	The U.S. and world experience a sharp, but reasonably short recession with noticeable recovery before year-end.	We didn't quite get to the twelfth year of the expansion as the outright halt in economic activity pushed the world into a sharp and deep recession. But, so far the evidence suggests that while this will be the deepest recession in post-World War II history, it will also prove to be the shortest.
		

2	Inflation and the 10-year U.S. Treasury yield end the year above 2% as the Fed stays on hold through the election.
	

2a	All-time low yields move higher during the second half, with the 10-year Treasury closing the year above 1%.	The yield on the 10-year Treasury plummeted to record lows amid the heart of the crisis in March, and has since been moving in fits and starts. The yield did get close to 0.9% earlier in the second quarter before falling again and ending the quarter just below 0.7%. ² As economic growth starts to improve, and as investors move back into risk assets, we think bond yields will rise modestly. An increase in the 10-year yield to over 1% would be a sign that the economy is reaccelerating.
		

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The recession has already ended, but we may not get back to expansion mode until late 2021 or 2022.”

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Earnings fall short of expectations, partially due to rising wage rates.



3a

Earnings collapse, but rise smartly by the fourth quarter.



Going into 2020, we thought earnings expectations for 2020 were too high. Expectations have since collapsed, although obviously not for the original reasons we anticipated. At the start of the year, the bottom-up consensus for S&P 500 earnings per share was \$177, but has since dropped to \$124.³ Although second quarter earnings results are going to be abysmal, we expect a recovery by the end of the year.

4

Stocks, bonds and cash all return less than 5% for only the fourth time in 25 years.



This is one of the three predictions we left unchanged. Markets experienced this phenomenon in 2005, 2015 and 2018.² At the mid-point of 2020, stocks have performed better than we would have expected three months ago, but are still in negative territory for the year. With the Fed anchoring short-term rates at zero, cash returns have been miniscule. Bonds are ahead of where we thought they would be (The Bloomberg Barclays U.S. Aggregate Bond Index is up 6.1%),² but that could change if longer-term yields rise.

5

Non-U.S. stocks outpace U.S. stocks as the dollar retreats.



5a

The dollar weakens as global growth strengthens in the second half.



This prediction was originally based on our view that the U.S. dollar would fall and that non-U.S. stocks offered better relative valuations. During the crisis, however, non-U.S. stocks have been hit even harder than their U.S. counterparts and have not recovered as quickly. The value of the dollar fell during the second quarter and is basically flat for the year. We expect improving global growth will put downward pressure on the dollar in the second half of this year. Massive U.S. deficits will also act as a drag.

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Markets may remain volatile for some time, but one year from now we expect stock prices to be higher than where they are today.”



Value and cyclicals outperform growth and defensive stocks.



Value and cyclicals outperform growth and defensive stocks in the second half.

As of now, the Russell 1000 Value Index (-16.3%) is significantly trailing the Russell 1000 Growth Index (+9.8%), and cyclical sectors (-8.4%) are slightly behind defensive sectors (-6.5%).² As the economy continues to recover, we think value and cyclical areas should do better in the second half of the year.



Financials, technology and health care outperform utilities, real estate and consumer discretionary.



Financials, technology and health care outperform utilities, energy and materials in the second half.

For our original prediction, a basket of financials, technology and health care is down -3.2%, while one of utilities, real estate and consumer discretionary is trailing at -4.1%.² Regarding our revised prediction, our list of favored asset classes didn't change, and a basket of our least-favored asset classes is down significantly at -17.8% for the year.² Technology and health care should continue to do well in an environment of quantitative easing, and financials as a sector appears undervalued to us.



Active equity managers outperform their indexes for the first time in a decade.

This is the second of our predictions that did not change. As of the end of May, just over half of large cap U.S. managers beat their indexes.⁴ We think opportunities for active management from here are relatively high. In our experience, active managers generally have a tailwind when small stocks beat big stocks, non-U.S. stocks outperform, equity returns are relatively low, value beats growth, correlations are low, economic growth improves and interest rates rise. We think most of that will happen in the second half of 2020.

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9

The cold wars within the U.S. and between the U.S. and China continue.



This is our third unchanged prediction. And, sadly, it is one that is proving to be correct. An optimist would hope that Americans would have used this time of crisis to pull together, but the opposite seems to be the case as political and social divisions within the United States have worsened since the start of the crisis. And the relationship between the U.S. and China appears to be deteriorating as the countries move from being competitors to adversaries.

10

The U.S. concludes a tumultuous political year with a status quo election.

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The coronavirus recession and rise in unemployment cause Donald Trump to be a one-term president.

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President Trump’s popularity and poll numbers have been dropping sharply in recent months, and the possibilities of a Democratic sweep of the White House and Congress are growing. Four months is a long time in politics, and we could see trends change. Should a sweep occur, it would represent a substantial change in the government’s tax and regulatory policies that could have significant implications for financial markets.

For more information, please visit nuveen.com.

Sources

- 1 Bureau of Labor Statistics
- 2 Bloomberg, FactSet and Morningstar Direct
- 3 Credit Suisse
- 4 Bank of America Merrill Lynch Research

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Glossary

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 of 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 a 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. The **MSCI World Index ex-U.S.** is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets minus the United States. 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. The **Russell 1000® Value Index** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The **Russell 1000® Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

A word on risk

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