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Weekly Investment Commentary

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Technology stocks drag equities lower

All major equity indexes finished lower last week, with the S&P 500 down 0.3% and the technology-heavy NASDAQ down more than 1%.[1] Despite a meaningful reprieve last Monday, growth and momentum factors lagged given stretched valuations, crowded positions and elevated earnings expectations. Value and cyclicals outperformed, but upside was limited amid continued signs that the economic recovery may be stalling. Concerns were exacerbated by lack of progress on a widely expected fifth virus relief bill. Energy, consumer discretionary and financials performed best, while technology and communications services were the worst.[1]

HIGHLIGHTS

- **The European Union's massive fiscal plan and expectations of another large fiscal package in the U.S. have raised hopes of continued fiscal support.**
- **Good news on vaccines and treatments for COVID-19 helped offset ongoing bad news from rising infection rates in parts of the world, especially in the U.S.**
- **U.S. stock valuations are elevated and do not provide a cushion against bad news, so we urge near-term caution.**

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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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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10 observations and themes

1) Initial jobless claim filings increased from 1.3 million the prior week to 1.4 million.[2] This result was a disappointment and marked the first weekly increase reported since March. The data may be signaling that the economy has lost momentum following the solid improvement throughout much of April and May.

2) The Senate's stimulus proposal saw a delay on GOP policy disagreements. We still expect bipartisan negotiations will lead to a bill supporting the economy and virus response to the tune of $1.5 to $2 trillion by early- to mid-August.

3) Earnings per share are expected to decline by 40% or more in the second quarter, even though so far earnings have generally exceeded estimates with nearly 30% of S&P 500 companies reporting.[3]

4) Second quarter real GDP will likely be down between 30 and 35%, according to the first official government estimate due out this week.

5) The U.S. dollar made a technical breakout on the downside, increasing the odds of further declines. Should this happen, it should help lift U.S. growth and S&P 500 earnings, but would increase the odds of U.S. inflation

6) U.S./China tensions ratcheted up again. The U.S. ordered China to shut its Houston consulate amid accusations that it and other Chinese diplomatic missions engaged in economic espionage and visa fraud. In retaliation, China ordered the U.S. to shut down its consulate in Chengdu.

7) Market breadth is the narrowest we've seen in 20 years, meaning that fewer stocks are participating in rallies.[1] Breadth began to deteriorate noticeably after the early June market high. Deteriorating breadth is rarely a good sign for the market, and we would caution against chasing stocks higher. We are closely monitoring risks such as the high concentration of returns in a handful of technology titans, the Fed's balance sheet leveling off, a potential fiscal cliff and the possibility of a Democratic sweep that is not yet priced into equities.

8) The market seems to have started discounting a potential rise in inflation over the coming years. Higher inflation breakeven rates and earnings that have generally exceeded estimates with nearly 30% of S&P 500 companies reporting.[3] Gold and commodity prices are all consistent with an upward drift in consumer prices over the next couple of years. Low productivity growth and the decline in the dollar will also feed into potentially higher inflation.

9) Both bonds and equities now look expensive, after a sharp recovery in equities and little sell off in bonds following the coronavirus bear market. This points to a period of time where we're likely to experience below-average returns and potentially above-average volatility.

10) U.S. equities have lagged the rest of the world since mid-May, and we believe there is greater opportunity in non-U.S. equities compared with the S&P 500. The U.S. has been overvalued relative to non-U.S. for some time, pushing bargain hunters to look outside the U.S. Coronavirus trends and short-term economic indicators suggest that Europe is handling the pandemic better than the U.S., which could have ramifications for regional equity markets down the road.

Elevated U.S. equity valuations cannot cushion against bad news

Further good news on vaccines and treatments for COVID-19 helped to offset ongoing bad news from rising infection rates in parts of the world, especially in the critically important U.S. economy. The European Union's (EU) massive fiscal plan and the agreement to issue joint liability debt, combined with expectations of another large fiscal package in the U.S., have raised hopes that fiscal support will continue until the pandemic recedes as an economic hazard.

Despite messy politics and the general desire to constrain increasing budget deficits, most policymakers understand that a premature end to fiscal support would risk and economic, and therefore political, disaster. Central banks have been on board since March, and more politicians acknowledge the need to stay the course.

While favorable, these developments still leave us cautious on the equity market in the near term, given that stock prices have already discounted a lot of good news. At 22 times 12-month forward earnings, U.S. stock valuations appear elevated and do not provide a cushion against bad news.[1] Setbacks in fighting the pandemic will not derail the general reopening trend, but they underscore that the economic recovery may be long and bumpy.

A temporary equity setback could occur if certain U.S. economic data points disappoint. Employment data will be critical to monitor, given the risk that some of the temporary layoffs will become permanent. We do not expect the economic recovery to come to a halt, but the path will be bumpy and varied. Last week's EU deal is a major step forward in the path to fiscal unity and reduces the longer-term risk of a breakup in the euro. Meanwhile, the U.S. dollar's luster is fading, and further dollar weakness would not be a surprise. We would only expect a gradual decline, which would make international equities more attractive.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-0.3%	0.6%
Dow Jones Industrial Avg	-0.7%	-6.0%
NASDAQ Composite	-1.3%	16.1%
Russell 2000 Index	-0.4%	-11.4%
MSCI EAFE	0.4%	-7.0%
MSCI EM	0.6%	-3.2%
Bloomberg Barclays US Agg Bond Index	0.4%	7.4%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 24 July 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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1 Source: Bloomberg, Morningstar and FactSet
2 Source: Department of Labor
3 Source: Credit Suisse

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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