For stocks, the long-term outlook is better than the near-term

Stock prices rose again last week, as investor optimism over vaccine prospects continues to push investor sentiment higher. The S&P 500 Index advanced 1.7%, with value styles modestly outperforming growth (although all areas had pockets of strength and weakness). Among sectors, energy led the way, while health care and technology also rallied. More defensive areas of the market lagged, with utilities declining more than 2%. In other markets, Treasury yields rose while the U.S. dollar continued to fall.

HIGHLIGHTS

- **Stocks continue to rally, with markets now firmly above their pre-pandemic highs.**
- **These price increases seem somewhat warranted, since prospects for vaccine availability next year should mean a return to more normal economic conditions.**
- **However, much of the good news is already priced in to markets and stock valuations appear full.**
- **We think prospects for equities in 2021 appear solid, but the next few months could be quite rocky as economic growth suffers due to the worsening pandemic.**

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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.

10 observations and themes

1) Slowing jobs growth suggests that the ongoing pandemic is taking a toll on economic growth. The sharp slowdown in new jobs numbers in November to 245,000 indicates that economic activity is again being curtailed. We expect vaccine rollouts next year will help matters, and believe the U.S. unemployment rate could return to 5% by the end of next year.

2) Manufacturing activity also trailed off last month. The ISM Manufacturing Index fell from 59.3 to 57.5 in November, below expectations. That number is still positive, but is further evidence of slowing growth.

3) With the pandemic likely to worsen over the coming months, we expect additional near-term negative economic readings. Vaccines should become widely available during the first half of 2021, but that leaves plenty of time for additional economic lockdowns. This is happening while support from fiscal stimulus is waning.

4) The weaker U.S. dollar suggests continued improvement for long-term global growth. Emerging markets should particularly benefit from the weaker dollar, as well as cyclical stocks.

5) Likewise, improving copper prices are a good sign for global growth. Historically, copper has been the commodity with the highest correlation to global growth, and prices have recently moved to multi-year highs due to high demand from China and many emerging economies.

6) Prospects for a near-term fiscal stimulus package are improving. Democratic leaders in Congress appear to be moving toward accepting the $900 billion bipartisan compromise deal, while President Trump has signaled he would also support this bill. This relatively modest package would help support small businesses, individuals receiving unemployment benefits, state and local governments and the education and health care sectors of the economy.

7) We think the odds of a government shutdown this month are low. Congress and the White House have until December 11 to pass a bill to fund the current fiscal year. We expect that will happen, possibly with a continuing resolution that extends the deadline several weeks.

8) The January 5 Georgia Senate runoff elections could significantly affect financial markets. Republicans need to win one of the races to maintain control of the Senate. At this point, betting odds suggest around a 65% chance of that happening, but those odds are falling. Should Democrats manage to capture both seats, the much more progressive tone in Washington would affect everything from tax rates, health care policy, climate initiatives and financial regulations.

9) High levels of cash on corporate balance sheets should be deployed in shareholder-friendly ways next year. In particular, we expect companies to pay down debt, maintain or grow their dividends and buy back their own stocks.

10) The recent stock market rally may have produced overbought conditions. The S&P 500 Index jumped 10% last month, while global equities enjoyed their strongest month in 25 years. Valuations look stretched, investor confidence is very high and volatility has been low. From a contrarian perspective, these are worrying signs.

Investor optimism may be too high

On the surface, it's understandable why stock prices have been soaring over the last month. The good news on the vaccine front portends economic normalization next year, the U.S. election produced no major surprises, monetary policy should remain hyper-accommodative, fiscal support should continue and negative real rates for government bonds are supportive for risk assets.

But that outlook doesn't reflect some significant risks, and all of this good news is already priced into the markets. Earnings expectations for 2021 and beyond suggest a very strong recovery from levels that were only moderately depressed in 2020. Stock valuations are elevated by historic standards, and credit spreads are quite tight. And we may still see additional economic lockdowns in the coming months as the pandemic worsens before it gets better.

As such, we think markets are ripe for disappointments and investors appear overly optimistic about the prospects for stocks and other risk assets. At this point, we think markets look overbought and equities have probably "borrowed" some of 2021's returns, meaning we could be in for a period of consolidation or correction in the near future.

Beyond a period of uncertainty over the next few months, we think the outlook is brighter. We expect stocks to deliver moderately positive returns next year, with U.S. earnings rising somewhere around 20%, offset by a modest decline in valuations. Geographically, we also think improving global growth makes emerging markets equities particularly attractive and expect non-U.S. stocks to outperform the U.S.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	1.7%	16.5%
Dow Jones Industrial Avg	1.2%	8.3%
NASDAQ Composite	2.1%	40.1%
Russell 2000 Index	2.0%	14.8%
MSCI EAFE	1.0%	5.9%
MSCI EM	1.7%	14.7%
Bloomberg Barclays US Agg Bond Index	-0.4%	6.8%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 04 Dec 2020. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results.

"Beyond a period of uncertainty over the next few months, the outlook for stocks is brighter in 2021."

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Endnotes

Sources

All market data from Bloomberg, Morningstar and FactSet

Employment data from the Department of Labor

Manufacturing data from the Institute for Supply Management

Election odds from PredictIt

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