

25 January 2021

Equity markets experience a sense of déjà vu

U.S. equities hit new highs last week before pulling back on Friday. Broad indexes were positive for the holiday-shortened week with leadership shifting from coronavirus-impacted cyclical and value stocks that have led recently, back to growth and defensive stocks that dominated most of 2020. The S&P 500 was up 2.0%, led by communications services (6.0%), information technology (4.4%) and consumer discretionary (3.1%). Energy, financials and materials stocks lost between 1% and 2% each.

HIGHLIGHTS

- **The inauguration of President Biden and Vice President Harris occurred without incident, easing tensions from the January 6 attack on the Capitol.**
- **Multi-day rolling averages of new coronavirus case growth showed signs of decelerating last week, as did hospitalizations. If these trends hold they should provide a boost for equity market gains.**
- **Fervor over Biden's \$1.9 trillion stimulus plan simmered on Friday as a power struggle in a nearly split Senate appeared to derail bipartisan support for the fiscal package.**



Saira Malik, CFA

CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen as chair of the Equities Investment Council (EIC) and a member of Nuveen's Global Investment Committee (GIC). She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies, as well as portfolio management responsibilities for global equity strategies.

Weekly overview

- *Broad index gains and losses continue to be localized, rather than broad-based. Recent leadership in cyclicals and small caps at the expense of large caps and growth names reversed last week. The Russell 2000 fell for the week, while the tech-heavy Nasdaq Composite ended at a record high of 13,543.*
- *Persistently elevated jobless claims (around 900,000 to 1 million), concerns over new coronavirus variants and dwindling stimulus optimism fueled the pro-growth sentiment. However, flash service and manufacturing sector PMIs exceeded expectations.*
- *According to Bank of America, a record \$255 billion flowed into equities over the past three months, concentrated largely in cyclical sectors such as financials and materials. While near-term headlines may create choppy trading, it looks to us like investors are positioned for another run-up in risk assets.*
- *The Fed pushback over fears of an impending taper tantrum caused Treasury yields to settle, following what had been a rapid steepening of the curve that began the year.*

Market drivers & risks

- **The more things change ...** This past week marked the one-year anniversary of the first U.S. case of COVID-19, and remarkably, the broad market narratives remain essentially unchanged: Historic monetary and fiscal policy continue to create a backstop, limiting damage to the economy and to markets. However, for a real recovery to occur, we need to see advancements in the distribution and efficacy of vaccines,



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leading to sustained improvements in key covid-related metrics.

- We are confident that we will see another round of fiscal stimulus – despite recent partisan rumblings in Congress, and we think we are nearing the end of the health care crisis. This should continue to reinforce our modest risk-on positioning based on earnings growth driven by the expected economic recovery later this year.
- **Staying balanced.** The cyclical/value rotation of the past few months reversed last week on negative stimulus and vaccine-distribution headlines. Such an environment underscores the importance of a balanced approach to equity portfolio construction.
 - Partnering defensive and higher-quality growth stocks with quality cyclicals (especially small cap stocks) to create a “barbell” portfolio could offer the opportunity to capture the remaining upside of the former, while tapping into the potential downside protection of the latter.
- **Earnings continue to outpace expectations.** Thus far, fourth quarter 2020 results have been robust with positive earnings surprises:
 - Approximately 65 S&P companies have released actual results, with 86% and 82% of those companies reporting positive EPS and revenue surprises, respectively.
 - In aggregate, earnings have surpassed estimates more than 22%.
 - The financial sector is now projected to have the strongest bottom-line growth among all sectors.

Risks to our outlook

The pace of coronavirus vaccine distribution appears to be accelerating and a recent executive order pledging 100 million doses in 100 days should help alleviate concerns. However, sustained challenges could lead to worse-than-expected economic growth, negatively impacting our modest risk-on positioning.

Additionally, volatility is likely to increase should a partisan rift cause a prolonged delay in additional fiscal stimulus.

The next few months could remain challenging for investors, and continued high volatility and possible near-term market selloffs are likely. Nevertheless, stock prices have been highly resilient in recent months, and the Volatility Index (VIX) has retreated to pre-coronavirus levels of 20-30 since November.

In focus

Earnings should drive 2021 equity returns

We expect earnings to continue to be the primary the driver of equity returns this year. As interest rates rise unevenly, and we start to consider how and when inflation may affect the markets, we also expect elevated multiples to unwind. But despite challenges, we may start to see more bullish commentary about company fundamentals.

We often discuss if particular sectors are extended on the basis of earnings contribution compared to sector weight. As an example, we believe that a steeper yield curve and higher interest rates should benefit the financial sector, and our favorable view toward financials further increases when considering that while financials make up 10% of the market cap, they account for almost 18% of S&P 500 earnings-per-share. We could also consider a sector like technology (where we are becoming more selective), where the 28% of market cap is only slightly ahead of the 25% of S&P 500 EPS.

In contrast, while earnings growth for consumer staples looks healthy, we expect their high growth to quickly normalize to lower growth rates as people stop heavily relying on staples and return to normal buying patterns. We think the market is already looking through these unsustainably high growth rates as evidenced last week by the mediocre (downward) stock price reaction to a key consumer-staples giant's reaction to a healthy earnings report.



Best ideas

We believe U.S. small caps offer value and are also favorable toward emerging markets equities. Overall, our key investment theme centers on looking for quality across geographies, sectors and industries. Dividend-paying (and growing) companies should remain attractive in a low-rate environment. However, we have observed an uptick in rates in 2021 and will monitor the space.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers averaging three decades of investing experience. The group brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

For more information or to subscribe, please visit nuveen.com.

Sources

All market data from Bloomberg, Morningstar and FactSet

Employment data from the Department of Labor

Earnings data from Strategas.

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A word on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income.

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