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Weekly Investment Commentary

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Stocks have made no forward progress for 18 months

Trade headlines dominated investor attention last week, as high levels of market volatility persisted. The S&P 500 Index fell 3% on Monday before clawing back most of those losses to end the week down 0.4%.[1] The defensive REITs and utilities sectors fared best, while energy and financials performed worst.[1] Bond yields continued to fall, with the focus again turning to whether yield curve inversion and negative global interest rates are a growing signal of recession. Investor sentiment was also hurt by ongoing confusion over Federal Reserve policy and deteriorating corporate earnings fundamentals.

HIGHLIGHTS

- **Investors are right to focus on the negative aspects of trade issues, due to growing risks to the economy and financial markets.**
- **We think the odds for a broad global economic rebound have fallen, but we don't yet see signs of a U.S. recession.**
- **Prospects for future significant gains in stocks appear dicey, meaning investors should focus on selectivity.**

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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.

Trade issues remain a serious economic and market threat:

Over just the past two weeks, trade negotiations ended without prospects for additional talks, President Trump announced new U.S. tariffs that will go into effect on September 1, China allowed the yuan to sink below the psychologically important seven-to-one ratio to the dollar while also suspending U.S. agricultural imports, and the U.S. Treasury labeled China as a currency manipulator.

By our estimate, the trade war has already caused a 0.5% annualized hit to U.S. GDP growth, and the new tariffs could add 0.25% more. At the margins, trade tensions will probably make the Fed more biased toward rate cuts. But both countries may need to realize more economic damage before an agreement can be reached. At this point, we don't think the U.S./China trade war will result in an outright recession, but it is clearly causing significant economic and financial market damage.

Risks are rising, but recession does not appear imminent

Over the past several weeks, we have cautioned investors about further equity volatility given weak global economic growth (chiefly in trade and manufacturing) and unclear prospects for a U.S./China trade deal. We had been holding out hope that such a deal could pave the way for an economic rebound, but recent tensions suggest those prospects are becoming less likely.

But that doesn't mean that the U.S. is heading for a near-term recession. Credit markets remain solid: Credit spreads have widened only slightly, loan demand is stable and banks remain willing to extend loan to businesses and consumers. At the same time, initial jobless claims are low, with high numbers of job openings. Consumer confidence remains high and income levels are expanding.

To be sure, trade problems are hurting business confidence and earnings, and escalating tensions could cause any weakness in trade and manufacturing to spill into the broader economy. While we think prospects for a global growth rebound have weakened, we don't see signs of a U.S. recession.

Stocks will likely move in a volatile, sideways pattern

While bear market bottoms are usually V-shaped, bull market tops typically progress in long saucer-shaped patterns. And we think it is possible we are in the peak of the bull market.

Remember that the S&P 500 Index first reached the 2,950 level in January 2018, before hitting it again last fall, in early May 2019 and a few weeks ago.[1] Over the past 18+ months, we have seen high levels of volatility without real upward progress. And almost all other broad-based U.S. and global equity market indexes (including the equal-weighted S&P 500) are lower over that same time period.[1] In our view, this accurately describes the top of a bull market.

Market fundamentals, monetary policy, market valuations and investor sentiment are all mixed and seem to be deteriorating. It's very possible that markets will again return to the 2,950 level once again (or several times). But it is feeling like prospects for a significant and prolonged upside breakout are diminishing with the passage of time.

We may not see significant downside action in the markets any time soon, but at some point the business cycle will mature and the current economic expansion will come to an end. When the next recession does come (our best guess is at some point in 2021), we will almost certainly see an accompanying corporate earnings decline and equity bear market.

As such, we think the risk/reward tradeoff for stocks is neutral in the near term and will eventually become more negative. This suggests a cautious approach toward equity markets.

What does that mean for investment positioning? First, it remains critically important to be nimble and remain highly selective. In most cases, defensive and growth areas of the market are a natural choice in the later stages of a bull market.

But defensive stocks are quite expensive, as are many of the mega-cap growth stocks that dominate indexes and ETFs. We think investors should thread the needle by focusing on soft cyclicals with improving prospects and strong cash flows, as well as on unexploited growth stocks with reasonable valuations.

2019 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-0.4%	17.8%
Dow Jones Industrial Avg	-0.6%	14.4%
NASDAQ Composite	-0.5%	20.7%
Russell 2000 Index	-1.3%	13.1%
Euro Stoxx 50	-0.3%	12.3%
FTSE 100 (UK)	-2.2%	5.2%
DAX (Germany)	-0.7%	8.5%
Nikkei 225 (Japan)	-0.9%	9.4%
Hang Seng (Hong Kong)	-3.8%	2.7%
Shanghai Stock Exchange Composite (China)	-4.9%	10.8%
MSCI EAFE	-1.1%	9.8%
MSCI EM	-2.2%	3.7%
Barclays US Agg Bond Index	0.6%	7.8%
BofA Merrill Lynch 3-mo T-bill	0.1%	1.5%

Source: Morningstar Direct, Bloomberg and FactSet as of 9 Aug 2019. 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: FactSet, Morningstar Direct and Bloomberg

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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