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Coronavirus concerns spark a renewed risk-off trade

Investor attention remains dominated by the possible economic impacts of the coronavirus. Investors had temporarily returned to a risk-on stance, on hopes that the virus had peaked, but a more defensive flight-to-quality trade took hold last week on news of additional outbreaks. For the week, the S&P 500 Index fell 1.2%.¹ The technology and financial sectors led the way lower, while more defensive areas held up better.¹ Treasury yields also fell last week, with the yield curve flattening slightly.¹

HIGHLIGHTS

- **Coronavirus-related economic fears continue to dominate markets, but we believe effects will be short term and limited.**
- **Once investors begin to look past near-term risks, we think areas of the global financial market that have benefited on a relative basis (growth styles, defensive areas and bond market proxies) could take a hit.**
- **On balance, we think the equity bull market should continue, but we are concerned that valuations look stretched in some areas.**



Robert C. Doll, CFA

*Senior Portfolio Manager
and Chief Equity Strategist*

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.

Weekly top themes

1

Despite near-term risks, we expect coronavirus-related economic issues to be contained. Markets have been in a risk-off mode, with more defensive and growth areas of the equity market outperforming in 2020. In our view, economic conditions would have to worsen significantly for this trend to continue, which we think is unlikely.

2

We believe 2020 will still be a year of economic recovery. Before the virus, economic optimism was rising given easing trade issues. We still think the global economic positives outweigh the near-term risks, and expect the U.S. and global economies will accelerate modestly this year.

3

While inflation is not a problem, it does appear to be picking up. The January Producer Price Index showed a 0.5% increase, the strongest advance since October 2018.² This came despite falling energy prices, as prices increased across services, construction and core goods.

4

Equity markets may be vulnerable to a correction. Following surprisingly strong returns in 2019, U.S. equity markets have continued to advance in 2020, despite the coronavirus fears. At the same time, earnings expectations have been falling. The combination of rising prices and declining earnings expectations may have pushed some areas of the market to be overvalued.

5

In particular, we are concerned that some growth, momentum and defensive areas look vulnerable. These areas have been outperforming on a relative basis for some time and appear stretched. In our view, once investors look past near-term risks and focus on the prospects for better long-term economic growth, this trade could reverse.

6

Likewise, the U.S. dollar could be overvalued. The strength of the dollar is somewhat counterintuitive, given the size and growth of the U.S. budget and current account deficits. But the increase appears to be part of the broader flight-to-quality trade that could unwind if and when coronavirus concerns fade.

7

Related to all of this, non-U.S. stocks could start to outperform. Most global markets are in negative territory for 2020, but U.S. stocks have posted gains. In our view, this is largely because the U.S. market is more growth-oriented with a higher relative weighting in bond-market proxies. An environment of better global economic growth should help non-U.S. markets on a relative basis.

Equity valuations are high and this bull market is old — but that doesn't mean a bear market is imminent

Most investors seem to expect the economic damage from the coronavirus will be moderate and largely contained, likely pushing back an economic rebound rather than derailing it. The extent of negative effects on corporate earnings is an important wildcard. Expectations for 2020 earnings growth had already been declining before the virus hit, and forward guidance from corporate management teams has trended more negative as results have been released.

We expect additional near-term disruptions to global economic growth in the coming months, especially as it relates to manufacturing and trade levels. We have already seen significant damage to the Chinese economy. And Europe (which has a much more export-oriented economy than the United States) is showing negative effects on growth. The economic silver lining of the coronavirus is that economic worries have suppressed bond yields and delayed a possible shift to tighter monetary conditions. Central banks remain extremely accommodative and show no signs of shifting policy, despite resilience in the service and consumer sectors.

From a markets perspective, investors appear more optimistic about longer-term growth prospects than at any point during the eleven-year-old recovery and expansion. Investors strongly believe that central banks will be able to stave off recession, despite coronavirus-related risks. The bearish interpretation of such a backdrop is that investors are overly complacent. We believe this is a typical indication of a late-cycle bull market. We think equity valuations look stretched, especially for the more defensive, growth-oriented and bond-like sectors. We would not be surprised to see additional volatility and some corrective action (especially within the more highly-valued areas of the market), but no near-term catalysts are emerging that would cause a recession or actual end to the equity bull market.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	-1.2%	3.6%
Dow Jones Industrial Avg	-1.4%	1.9%
NASDAQ Composite	-1.6%	6.9%
Russell 2000 Index	-0.5%	0.7%
Euro Stoxx 50	-0.9%	-1.6%
FTSE 100 (UK)	-0.5%	-3.6%
DAX (Germany)	-1.1%	-0.7%
Nikkei 225 (Japan)	-3.0%	-3.6%
Hang Seng (Hong Kong)	-2.1%	-3.1%
Shanghai Stock Exchange Composite (China)	3.6%	-1.3%
MSCI EAFE	-1.2%	-1.5%
MSCI EM	-2.0%	-2.6%
Bloomberg Barclays US Agg Bond Index	0.6%	2.5%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.2%

Source: Morningstar Direct, Bloomberg and FactSet as of 21 Feb 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

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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