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Weekly Investment Commentary

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Risks are high, but stocks could be near oversold territory

Stocks sold off sharply last week, driven by growing fears over the coronavirus. The S&P 500 fell 11%, suffering its worst weekly decline since October 2008.[1] Stocks are now 13% below their February all-time high, after being down as much as 16% from that mark early on Friday.[1] This decline marks the fastest 10%+ correction in U.S. history.[1] Given that stocks were looking overvalued and overbought in early February, the markets' decline isn't surprising. But the speed and scope certainly is.

HIGHLIGHTS

- **The massive selloff in stocks last week could mean investors are in for a prolonged, painful bout of both upside and downside volatility.**
- **The downside economic and market risks related to the coronavirus are rising, but we still don't believe the U.S. is heading for a recession.**
- **While last week's selloff may have been an overreaction, and stocks are more attractively valued now, it's too early to call a market bottom.**

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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.

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The Chinese economy remains key to the global outlook

The coronavirus outbreak coincided with firming of previously weak global manufacturing and trade levels. Now, the economic outlook is highly uncertain as business closures, quarantines and travel restrictions are spreading. A race is on between how quickly the Chinese economy can restart and how soon global supply chains will be disrupted, affecting the U.S., Europe and other markets.

While new coronavirus cases in China are slowing, and China is starting to reopen parts of its economy, the macro shocks will likely continue. Chinese officials now forecast economic growth of around 5% for the first quarter, down from previously-announced forecasts of 6%. Those numbers seem too high, and we could possibly see negative growth levels in China for the first quarter. The big questions are how quickly China can recover to its decent pace of growth at the start of the year and how much the rest of the world will be affected.

The U.S. economy will take a hit, but a recession still looks unlikely

U.S. economic data over the past couple of weeks remained solid, but that will be the last data that doesn't reflect the impact of the coronavirus. Ultimately fear, panic and virus countermeasures will determine the scope and length of economic damage. The downside risk is the scope of the crisis is very difficult to predict and cannot be managed by changes in political, fiscal or monetary policy. The upside is that coronavirus economic damage is not likely to be a long-term recurring economic risk like a rise in tariffs or mounting protectionism.

In a worst-case scenario of a prolonged global pandemic marked by massive school and business closures, widespread quarantines and growing travel bans, we would almost certainly expect to see the U.S. and world enter a recession. Investors, consumers and business will be prone to increased panic as the virus hits closer to home. However, these effects are also likely to be relatively brief no matter how severe. Because the U.S. economy has strong underlying fundamentals (especially in the consumer sector), we don't believe a true recession or prolonged bear market will occur, but acknowledge that downside risks are extremely high.

Additional Fed easing looks likely

Federal Reserve policy represents one reason for hope. While monetary policy itself cannot prevent the likely economic damage, the Fed has made it clear it will respond as economic activity weakens. Markets are currently forecasting three rate cuts in 2020. Absent the spread of the virus, the Fed would likely have remained on hold before the U.S. election, but now rate cuts seem likely. Fed rate cuts are likely to boost investor sentiment and risk assets, which has been the case since the current economic recovery and expansion began over 10 years ago.

The political environment has also become less clear

The growing coronavirus threat has also changed the U.S. political landscape and increased uncertainty. President Trump had previously been benefitting from a strong U.S. economy and disarray in the Democratic primary process. Today, his election prospects face the risks of an actual economic decline and the fact that voters typically blame incumbents when things go wrong. A less-clear political backdrop is likely to contribute to market uncertainty and volatility.

U.S. stocks may be approaching a "tradeable low"

Market panics play out differently. Sometimes, we see a giant meltdown followed by a quick recovery, such as at the end of 2018 and early 2019. Other times, markets experience long waves of selloffs before stabilizing, such as during the financial crisis. At this point, it's too early to tell how the current panic will play out. The impact on economic growth and corporate earnings is still unknown. Some strategists have been forecasting flat earnings for 2020, but that seems mostly like a best guess.

Based on our assessment of the underlying economy and current valuations, our best guess is that we will look back at the current period of selling as an overreaction. We believe the current selloff should be viewed as a surprisingly fast and sharp correction driven by previously overvalued and overbought conditions and a potential drop in corporate earnings expectations, rather than a shift in underlying economic fundamentals. The relationship between equity prices and credit spreads is an important data point to consider. Typically, long-term collapses in stock prices happen in unison with major widening in credit spreads. That hasn't been the case over the last couple of weeks, as spreads (outside of high yield energy) have widened only modestly.

This does not mean we expect markets to necessarily rise from here. A rally will ensue at some point, but new highs could be a long time away. Investors should be patient, prudent and should not try to time an actual market bottom.

We could remain in a choppy and frustrating market environment for some time to come. For now, we think it makes sense to focus on companies selling at reasonable prices and that have free cash flow they can put to work. When we do see an eventual rebound, we think cyclical sectors and value styles could be poised for a bounce, but the timing remains elusive.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	-11.4%	-8.3%
Dow Jones Industrial Avg	-12.3%	-10.6%
NASDAQ Composite	-10.5%	-4.4%
Russell 2000 Index	-12.0%	-11.4%
Euro Stoxx 50	-11.2%	-12.6%
FTSE 100 (UK)	-12.2%	-15.4%
DAX (Germany)	-11.3%	-11.9%
Nikkei 225 (Japan)	-6.6%	-10.0%
Hang Seng (Hong Kong)	-4.1%	-7.1%
Shanghai Stock Exchange Composite (China)	-4.8%	-6.0%
MSCI EAFE	-10.0%	-10.9%
MSCI EM	-7.2%	-9.7%
Bloomberg Barclays US Agg Bond Index	1.3%	3.8%
BofA Merrill Lynch 3-mo T-bill	0.1%	0.3%

Source: Morningstar Direct, Bloomberg and FactSet as of 28 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

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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