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Weekly Investment Commentary

23 November 2020

Stock markets are looking beyond near-term risks

Investors last week focused on the positive coronavirus vaccine trials, as well as the negatives surrounding spiking virus cases and mounting economic lockdowns around the world. Diminishing prospects for a near-term fiscal stimulus package also weighed on the markets. As a result, global equity prices were mixed. The rotation away from defensive areas toward more cyclical parts of the market continued, as energy, industrials, materials and financials all outperformed, while utilities and REITs lagged.

HIGHLIGHTS

- **Dispersion is growing between the near-term risks of rising coronavirus cases and economic lockdowns versus the long-term positives of vaccine availability and better growth prospects. So far, markets are focusing on the positives.**
- **But we are increasingly concerned that the economy could stumble over the coming months, especially as the prospects for fiscal relief are fading.**
- **This creates potential near-term risks for stocks, but we believe the longer-term case for equities remains sound.**

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.

10 observations and themes

1) Financial markets have been focusing on the positives in recent weeks. Stocks have been largely ignoring the rising coronavirus cases, as investors are looking forward to vaccine availability and prospects for stronger economic growth in 2021.

2) While stock prices have been rising, high yield credit spreads have been narrowing. The improving economic outlook, better-than-expected earnings growth and increased liquidity have been sparking a risk-on trading phase.

3) Investor sentiment has improved sharply. Net bullish sentiment, as measured by the American Association of Individual Investors, rose from neutral to sharply bullish over the past several weeks. From a contrarian perspective, this suggests stocks could be vulnerable to a pullback.

4) More near-term economic pain is likely. New cases in Europe have been surging for some time, and rising U.S. infection rates are overwhelming some regions' health care systems. Policymakers also expect this week's Thanksgiving holiday could trigger an accelerated surge. All of this suggests that economic disappointments are likely over the coming months.

5) A lack of near-term fiscal stimulus is weighing on consumer spending. Retail sales rose only 0.3% in October, quite less than expected.

6) Manufacturing and production, in contrast, have held up well. Industrial production grew by 1.1% in October, above consensus expectations.

7) Global central banks continue to flood the markets with liquidity. Collectively, the assets of the U.S. Federal Reserve, the European Central Bank and the Bank of Japan rose from $7.2 trillion in March to a record $21.8 trillion in November. All three are also pushing their country's fiscal policymakers for additional stimulus.

8) Fiscal and monetary policymakers remain far apart. Last week's news that Treasury Secretary Mnuchin requested terminating several Fed lending programs (and the Fed's criticism of these plans) provides further evidence that it will be difficult to manage through economic turmoil in the coming months.

9) Corporate earnings have held up surprisingly well this year. S&P 500 2020 consensus earnings are now at $137, down only 15% year over year. Should that level hold, it would mark the mildest earnings recession since 1960.

10) Regulatory policies are likely to tighten in 2021. Next year, we expect President-elect Biden to advance a robust regulatory agenda that reverses much of President Trump's policies implemented over the past four years. The bulk of the action will likely be concentrated in energy, climate change and labor areas.

2021 should see an improving and self-sustaining recovery

A noticeable divide exists between the near-term and long-term outlook. Over the coming months, we think the sharp acceleration in coronavirus cases and the mounting economic restrictions and lockdowns (whether imposed by policymakers or self-imposed by businesses and individuals), are likely to translate into a period of rockier economic growth. We have seen some evidence of this trend: Last week's retail sales figures were disappointing, and weekly unemployment claims rose for the first time in a while. We also think that the lack of progress on a new fiscal stimulus package will likely hurt growth over the coming months.

Beyond that point, however, the outlook is brighter. The good news surrounding vaccine effectiveness and the prospects for widespread distribution in the first half of 2021 should improve economic mobility. And the Federal Reserve and other central banks have made it clear they will retain ultra-accommodative monetary policies, even if inflation creeps higher. This could create a risk that interest rates will rise more quickly than some expect, but it should also allow for the U.S. and most of the rest of the world to enter into a self-sustaining economic expansion. Some lasting economic damage due to the pandemic is likely, especially in the service sector, but the overall economic picture should look brighter in 2021.

So far, financial markets have been focusing more on the positive long-term outlook than on near-term risks. We think the recent sharp increases in equity prices could make stocks vulnerable to setbacks, especially if economic conditions deteriorate in the coming months. But once we see clearer signs that economic activity is returning to something approaching normal, and that the recovery is more durable, that should create a lasting tailwind for corporate earnings and stock prices.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-0.7%	12.0%
Dow Jones Industrial Avg	-0.7%	4.7%
NASDAQ Composite	0.3%	33.2%
Russell 2000 Index	2.4%	8.3%
MSCI EAFE	1.9%	2.5%
MSCI EM	1.8%	10.9%
Bloomberg Barclays US Agg Bond Index	0.6%	7.3%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 20 Nov 2020. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results.

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Endnotes

Sources

All market data from Bloomberg, Morningstar and FactSet

Retail sales and industrial production data from the Commerce Department and Federal Reserve

Central bank asset data from Yardeni Research

Earnings data from Raymond James

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