nuveen
A TIAA Company

Weekly Investment Commentary

11 January 2021

Equities begin 2021 strongly, although downside risks remain

Stocks started 2021 on a positive note. All major indexes rose at least 1.5% last week, and small caps soared higher by nearly 6%. Investors focused on the positives of stronger 2021 economic expectations and hopes for smooth vaccine rollouts, looking past stretched equity valuations. Investors also responded positively to the Democrats taking control of the Senate. For the week, value and cyclical styles outperformed, while Treasuries came under pressure. The 10-year yield rose above 1% for the first time since March.

HIGHLIGHTS

- **We see a number of reasons to be positive as we enter 2021: improving economic growth, better corporate earnings, a potentially calmer U.S. political landscape, accommodative policy and hopes that vaccine rollouts will finally end the devastating coronavirus pandemic.**
- **On the other hand, we think much of these positive trends have already been priced into markets.**
- **As such, stocks could be vulnerable in the near term. Prices should still advance in 2021, but are likely to trail the economic and earnings recoveries.**

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 market commentary on behalf of Nuveen's Equities Investment Council.

10 observations and themes

1) The change in Senate control should result in modest changes in the policy backdrop. We expect an increase in spending and more fiscal support, which are near-term positives for stocks. We also expect higher taxes (especially on higher-income Americans and corporations) and a more stringent regulatory environment, which could drag on the markets. But we don't anticipate a significant shift to a highly progressive environment, given the slim majorities in both houses of Congress and President-elect Biden's history of moderate stances.

2) More broadly, we expect a less fractious and volatile political environment from here. Following the shocking violence and turmoil in Washington last week, we anticipate an orderly transfer of power on January 20 and a calmer environment. We also hold out hope that moderate forces will come together on more bipartisan legislation.

3) We expect December's drop in employment will be temporary. The worse-than-forecasted 140,000 job losses came mostly from the leisure and hospitality industries, given forced closures in bars and restaurants. We don't believe the U.S. is heading back toward recession.

4) Manufacturing remains a bright spot for the U.S. economy. The headline ISM manufacturing survey increased from 57.5 in November to 60.7 in December, one of the highest readings in decades. While many service sectors remain under pressure, manufacturing indicators continue to look strong.

5) We expect a pickup in consumer spending in 2021. More fiscal stimulus, the vaccine rollout and an eventual recovery in jobs growth should all boost personal income, savings rates and spending over the first and second quarters.

6) Saudi Arabia's decision to unilaterally cut oil production by one million barrels per day is a near-term positive for oil prices. But it raises questions about how other OPEC nations will respond and could spark further price volatility in both directions.

7) It appears like much of the good news anticipated in 2021 has already been baked into the markets. Investors have already bid up stock prices on expectations of better growth, easing economic restrictions, improved earnings and continued policy support. As such, we find it hard to make a case that stock valuations can increase much more from here. That suggests some near-term caution is in order.

8) Investor sentiment indicators also look extended. Net bullish sentiment indicators, Bitcoin's tripling over the last few months and high new-issue volumes all signal elevated investor optimism.

9) We think cyclical sectors and small caps look relatively attractive in 2021. Prospects for stronger economic growth in the U.S. and around the world, extremely low interest rates, additional fiscal support and rising commodity prices are all tailwinds for these areas of the market.

10) Likewise, we favor non-U.S. stocks and especially emerging markets this year. These markets are significantly cheaper than U.S. stocks and should be helped by a more synchronous global economic recovery. The weakness of the U.S. dollar is also a positive factor.

2021: Great for the economy and earnings, but just OK for stocks

Investors started off 2021 the same way they ended 2020: by focusing on the positives of long-term improvements in economic growth, hopes that the vaccine rollout will allow more economic reopening and expectations that monetary and fiscal policies will remain highly supportive of risk assets. But the risk with this stance is that stocks are already discounting a highly favorable macro outlook and are expensive based on historic measures.

It appears to us that the economic recovery (and eventual expansion) is still in its early stages, but capital markets are much further along the cycle. Following the previous three recessions, it took several years for global equities to fully recoup their losses, but that happened in only a matter of months in 2020. Stocks and other risk assets could be vulnerable if economic growth is less robust than what is already priced into the markets. But at the same time, if growth is stronger than expected, that could create more upward pressure on interest rates and inflation, which would likely hurt equity valuations.

We expect equity returns to be relatively moderate (but still positive) in 2021, but to trail the recovery in the economy and corporate earnings. We also believe we will continue to see an uneven rotation away from growth, large caps and U.S. stocks toward value, small caps and non-U.S.

The bottom line: We see a number of tailwinds for the broad stock market in 2021. But given the extreme run up in prices in recent months, we also believe stocks have effectively "borrowed" from future returns. As such, we think equity returns will be and stock markets could be vulnerable to a near-term consolidation or correction.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	1.9%	1.9%
Dow Jones Industrial Avg	1.7%	1.7%
NASDAQ Composite	2.5%	2.5%
Russell 2000 Index	5.9%	5.9%
MSCI EAFE	3.2%	3.2%
MSCI EM	4.8%	4.8%
Bloomberg Barclays US Agg Bond Index	-0.9%	-0.9%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.0%

Source: Morningstar Direct, Bloomberg and FactSet as of 8 Jan 2021. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results.

"We expect equity returns to be relatively moderate (but still positive) in 2021, but to trail the recovery in the economy and corporate earnings."

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

Endnotes

Sources

All market data from Bloomberg, Morningstar and FactSet

Employment data from the Department of Labor

Manufacturing data from the Institute of Supply Management

A word on risk

nuveen
A TIAA Company

GWP-1473823CR-W0121P