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Weekly Equities Commentary

19 January 2021

Lofty expectations lead to equity-market losses

The optimism-fueled rally that started the new year weakened last week, as U.S equities contracted for only the third time in the past eight weeks. The S&P 500 fell by 1.5%, led by declines in communications services (-3.6%), information technology (-2.6%) and consumer staples (-2.0%). The energy and real estate sectors gained the most, up 3.2% and 1.9%, respectively.

HIGHLIGHTS

- **President-elect Biden detailed his economic package, which was largely in line with expectations, leading to "sell-the-news" activity.**
- **Equity indexes are not the only statistics approaching record highs. Coronavirus-related metrics continue to sadly surpass previous high-water marks, most notably in daily death tolls.**
- **Earnings season is likely to be under greater scrutiny relative to 2020, given investors' hopes for economic recovery in the wake of vaccine distribution.**

Saira Malik, CFA
CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen. She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies and provides ongoing market commentary on behalf of Nuveen's Equities Investment Council (EIC).

Weekly overview

- *Sector results continue to be mixed. Notably, the rally in cyclicals slowed as small cap stocks continue to outperform their large cap counterparts.*
- *Energy and real estate both benefited from stimulus headlines, as further fiscal aid stands to support both inflationary pressures and alleviate concerns surrounding commercial and residential rent collection.*
- *Last Thursday's unemployment number of 965,000 was significantly more than expected, although stimulus headlines damped any negative effect on the market.*

> *We anticipate this year's earnings seasons to take on a greater degree of importance."*

Market drivers & risks

- **Have high expectations set up markets for increased near-term volatility?** Equity market appreciation accelerated recently, especially within cyclical sectors, as vaccinations and further fiscal stimulus became foregone conclusions. However, last week's pullback may indicate that both market drivers have disappointed, somewhat.
  - The pace of vaccinations has indeed missed earlier goals thus far, with only 10 million people receiving doses versus original estimates of 20 million. These numbers are even more disappointing given that U.S. daily death tolls have reached 4,000.
  - The proposed $1.9 trillion stimulus package goes well beyond the package passed at the end of 2020, but falls just short of the $2.0 trillion that some may have anticipated (and may have even triggered some algorithmic selling late last week).
  - Though these issues are disappointing, we are still headed toward a vaccinated population and fiscal support. We suspect downside pressure caused by missed expectations will be short-lived.
- **$1,900,000,000,000.** President-elect Biden's $1.9 trillion stimulus plan will provide additional direct payments of $1,400, as well as supplemental unemployment benefits of $400 per week. More than $415 billion is allotted to "combat the virus" and distribute vaccines, including $350 billion to state and local governments and $440 billion to relieve the hardest hit businesses.
  - We are confident the final bill will support our modest risk-on positioning by fueling economic growth and broadening equity leadership. We continue to favor U.S. small cap stocks and high-quality cyclicals hit hardest by the pandemic.
- **Earnings season kicks off solidly.** We anticipate this year's earnings seasons to take on a greater degree of importance. The S&P 500's P/E multiple currently sits well above historical averages at around 20x, supported by vaccine and stimulus optimism, and we suspect there will be little room for "error" in results. Financials (namely banks) kick off this week, and we hope for solid results and positive outlooks given their largely untouched cash reserves and recent steepening of the yield curve.
  - Seven sectors reported either smaller declines or higher growth rates in earnings today compared with September 30 of last year.
  - Additionally, of the 26 S&P 500 companies reporting so far, 25 saw positive EPS surprises and 22 reported positive revenue surprises.

Risks to our outlook

We may see some turbulent trading this week, given tensions surrounding the U.S. presidential inauguration. We hope and trust that the events will proceed peacefully and allow everyone to move on from the events that unfolded over recent weeks.

The next few months could remain challenging for investors, and continued high volatility and possible near-term market selloffs are likely. On the plus side, stock prices have been highly resilient in recent months, recovering quickly from declines.

Though its pace appears to be accelerating, sustained challenges in distributing vaccines could lead to worse-than-expected economic growth, which would be a negative for our modest risk-on positioning. Likewise, the sharp rallies in lower-quality stocks immediately after the U.S. election would be a risk, as we are looking for a more normalized trading environment.

Best ideas

We believe U.S. small caps offer value and are also favorable toward emerging markets equities. Overall, our key investment theme centers on looking for quality across geographies, sectors and industries. Dividend-paying (and growing) companies should remain attractive in a low-rate environment. However, we have observed an uptick in rates in 2021 and will monitor the space.

In focus

Opportunities in small-cap stocks

Large cap equities dominated in 2020, but we believe the market will broaden this year. The environment for small caps began to improve in the fourth quarter amid signs of economic strengthening and promising vaccine headlines. We believe an allocation to small caps remains a vital component of a diversified long-term portfolio, with three potential catalysts leading to compelling opportunities.

Historically, small cap stocks have often outperformed the broader equity market during economic recoveries. They are more nimble and can quickly increase their workforces in anticipation of an improving economy. As a result, small caps may generate larger increases in revenues and earnings.

Small caps tend to suffer steeper declines early in a downturn as investors shift to larger, "safer" stocks. But this can create oversold conditions, which may set the stage for a stronger post-recession rebound. Notably, in 2020, the small cap Russell 2000 Index suffered a sharper decline (-31%) than the large cap Russell 1000 Index (-20%) during the pandemic-driven recession. But the Russell 2000 surged back, and outperformed its large cap counterpart, 59% versus 45%, between April and November.

Small caps have generated higher annual rates of return than any other U.S. equity or fixed income investment for nearly a century. Relative performance of small caps has varied over shorter periods, but recent dynamics suggest they may offer compelling opportunities.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers averaging three decades of investing experience. The group brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

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Sources

All market data from Bloomberg, Morningstar and FactSet

Employment data from the Department of Labor

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