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Weekly Investment Commentary

17 August 2020

Investors look past negatives as stocks approach record highs

U.S. equities finished higher for the third week in a row, with the S&P 500 up 0.6%.[1] The same factors pushed markets higher: low inflation, an ultra-easy Fed, historic liquidity and improving global economic and earnings-per-share growth. The bears continue to argue about the risks of renewed spread of coronavirus, double-digit unemployment, a potentially contested U.S. election and increased geopolitical tensions. Industrials and energy performed best, while utilities and REITs lagged.[1]

HIGHLIGHTS

- **The global economic recovery will persist, but there may be further bumps ahead.**
- **Low inflation, an ultra-easy Fed, historic liquidity and improving global economic and earnings-per-share growth push equity markets ahead, but risks still loom.**
- **We are cautious on the short-term outlook and expect some turbulence as the V-shaped economic rebound gives way to a choppy recovery.**

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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.

10 observations and themes

1) Initial jobless claims fell to 963,000 for the week, marking a pandemic low.[2] We're likely seeing some improvement in rehiring and a slowdown in layoffs.

2) Retail sales were up 1.2% in July. While the rate of growth is slowing, retail sales are up 30% from their April low and are now at an all-time high.

3) Deflation readings last spring turned inflationary in June and accelerated in July. Both the headline and core readings rose more than expected. The release boosted Treasury yields, as the dollar reflected inflation expectations. However, the inflation uptick is likely to be temporary.

4) The August economic cliff is in progress. With no government checks arriving in the mail so far, incomes could fall, and consumer confidence may drop again. If not addressed, this stimulus standoff could jeopardize fourth quarter GDP. Investors should be prepared for a risk-off episode in the stock market if Congress fails to compromise on a new fiscal stimulus package.

5) We expect at least one vaccine to be approved by the end of 2020 and widely distributed by mid-2021. If accurate, that could lift 2021 GDP by more than 5%.

6) As second quarter earnings season comes to a close, investors are shifting their focus to the second half of the year. After posting -33% in the second quarter, consensus expectations are -23% in the third quarter and -14% in the fourth quarter. However, third-quarter earnings estimates could be 20% more than second quarter, and the fourth quarter could be 12% higher than the third quarter.

7) Joe Biden selected Kamala Harris as his running mate, a move that was largely expected and had little impact on market sentiment. However, there seemed to be some relief that he did not tap someone more progressive.

8) The deal between Israel and the United Arab Emirates is a significant geopolitical event, and we're surprised that it didn't get more press attention. This will likely be viewed positively for other Persian Gulf kingdoms, including Saudi Arabia, making Iran and their surrogates the losers.

9) The debate between value cyclical and growth momentum stocks continued. Value cyclicals have outperformed with support coming from outsized positioning, valuation dispersion, momentum in leverage-to-macro and earnings-revision, inflation expectations and vaccine progress. Growth momentum, the big standout during the market rebound and years prior, remains leveraged to bank liquidity tailwinds, long duration and secular growth themes.

10) The equity-market rotation has been buoyed by continued strong monetary support, acceptable economic and earnings news and hopes for a vaccine. Defensive, low beta, big, U.S. and growth stocks have generally ceded leadership to cyclical, high beta, small, international and value stocks. This rotation has been accompanied by a lower dollar and higher commodity prices and depends on Washington passing another fiscal package.

The short-term outlook warrants caution

The continuing global economic recovery will be bumpier than what the markets reflect, so investors should be selective in their exposure to risk assets. The reacceleration in U.S. infections has triggered renewed restrictions in economic activity. While smaller, similar episodes have erupted around the globe, the U.S. carries additional risks: the stalled fiscal stimulus bill, uncertainty around the election, elevated valuations and uncertain future corporate profits. We are cautious on the short-term outlook, but expect some turbulence as the V-shaped economic rebound gives way to a more choppy recovery.

Investors have taken disappointing developments in stride, but stretched technicals and valuations imply vulnerabilities. On the positive side, central bank policy has successfully shored up credit markets. Narrowing U.S. high yield corporate bond spreads are only modestly above January levels, which is impressive relative to the implosion in corporate cash flows and the likelihood of a choppy recovery. Still, some profit taking is likely after the huge rebound since March 23. For example, gold fell last week.

The monetary and fiscal reflationary bridge must hold until a medical breakthrough occurs, otherwise the global economic recovery could falter. We doubt that such a breakdown will occur, but Congress is playing a perilous game. While we expect an agreement on a new fiscal package, the question is whether the financial markets need to correct first, pushing the two political parties to come together.

Corporate profits must steadily recover to sustain the equity rally beyond any near-term setbacks. The longer it takes to return to more normal economic and social activity, the greater the odds of permanently losing capacity, employment and profitability. We are generally constructive on the prospects for an economic and earnings recovery, but near-term disappointment is possible.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	0.7%	5.7%
Dow Jones Industrial Avg	1.9%	-0.7%
NASDAQ Composite	0.1%	23.5%
Russell 2000 Index	0.6%	-4.6%
MSCI EAFE	2.5%	-5.0%
MSCI EM	0.4%	-0.1%
Bloomberg Barclays US Agg Bond Index	-0.9%	6.9%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 14 August 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: Bureau of Labor Statistics

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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