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Weekly Investment Commentary

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A risk-on trade takes hold (for now)

Equities jumped higher last week, with the S&P 500 Index rising 2.2%. Positive news from a potential Pfizer coronavirus vaccine provided some hope for a return to more normal economic activity in the year ahead. Even more notable than the rise in markets was the sharp rotation that came with it, as cyclical stocks and value sectors strongly outperformed defensive and growth areas. In fact, the tech-heavy NASDAQ actually lost ground last week, falling by 0.5%.

HIGHLIGHTS

- **The sharp jump in stock prices reflects hope of eventual economic normalization next year, but the next few months could present a number of risks as the coronavirus pandemic worsens.**
- **We are seeing a clearer path for the U.S. and global economies to enter into a self-sustaining economic expansion in 2021.**
- **Signs of additional medical breakthroughs and/or indications that the economy is picking up could spark a rotation toward value and cyclical areas of the market.**

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.

Seven observations and themes

1) The positives of last week's news is hard to overstate. Normally, it takes years to develop a vaccine, so to achieve what looks like a 90% effective rate in less than a year is truly remarkable.

2) Until a vaccine is available, however, the virus continues to rage. The U.S. is seeing strains in many hospitals, and also starting to experience the same lockdowns as Europe. Europe is likely to re-enter recession, and that could also be a risk in the U.S. if conditions worsen.

3) Additionally, the logistics around delivering a vaccine remain challenging. Everything from vaccine storage, delivery and distribution on a massive scale must still be worked out. And the virus itself could mutate, which could make some vaccines less effective.

4) The vaccine announcement sparked a notable rotation in leadership. On Monday, we saw a sharp, technically driven rotation out of momentum, growth and defensive stocks and into the most beat up, volatile, cyclical and value areas of the market. In fact, value actually outperformed growth by nearly 6% on Monday, the largest one-day relative difference in seven decades. Continued good medical news could spark additional rotations, but it won't be a straight line.

5) Prospects for divided government are becoming clearer. As a result, we do not expect sweeping changes such as large tax increases or spending initiatives. We could see a compromise on fiscal stimulus and a modest infrastructure program. We do expect, however, a tighter and more costly regulatory environment.

6) The timing and magnitude of a new fiscal stimulus package are highly uncertain. The data suggest economic growth rates around the world peaked in early October and have since declined, especially in the euro area. The economy desperately needs more support. If it doesn't get it, that would represent a headwind for stocks.

7) At this point, we expect modest fiscal support, but maybe not until 2021. In particular, we think a package of somewhat less than $1 trillion is a possibility. But the timing may be delayed until next year given political division.

Odds are high that this recovery can eventually become self-sustaining

The global economic outlook improved sharply last week for two reasons: diminishing U.S. political uncertainty and encouraging medical signs. Although President Trump has not conceded, the odds of a Constitutional crisis appear low, and divided government is unlikely to result in massive policy changes. For the latter, signs of a successful vaccine provide hope that we will return to more normal economic activity at some point next year.

Managing through the pandemic and looking for ways to spark a more robust and sustainable recovery remain tall orders. In the immediate term, the surge in new cases and rising hospitalizations could slow U.S. growth, similar to Europe. Over the longer term, however, a path exists for the U.S. and global economies to rely progressively less on monetary and fiscal support. That would create a stronger tailwind for stocks and other risk assets, and should allow for a more sustained rebound in corporate profits.

If and when we do enter a stronger growth period (or, more to the point, when markets start to anticipate one), we would expect a market leadership rotation away from U.S. stocks and toward non-U.S. markets. Additionally, more leadership would be likely from cyclical sectors, value styles and small caps rather than defensive, growth and large caps.

The key takeaway: Five positives and negatives for stocks

POSITIVES:

1. Impressive news from the Pfizer vaccine and other vaccines is likely.
2. Election results avoided the blue wave.
3. Corporate earnings results in the third quarter were less bad than expected.
4. The Federal Reserve will step in as needed to support growth.
5. The consumer sector shows continued strength, with unemployment dropping to under 7%.

NEGATIVES:

1. Vaccine logistics and distribution are complex, and the virus could mutate.
2. Fiscal stimulus could be too small or too late.
3. Additional coronavirus flare-ups could worsen the humanitarian crisis and hurt economic activity.
4. Interest rates could rise.
5. Valuations for equities are not particularly attractive.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	2.2%	12.8%
Dow Jones Industrial Avg	4.2%	5.4%
NASDAQ Composite	-0.5%	32.9%
Russell 2000 Index	6.1%	5.8%
MSCI EAFE	3.9%	0.6%
MSCI EM	1.0%	9.0%
Bloomberg Barclays US Agg Bond Index	-0.1%	6.7%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 13 Nov 2020. All index returns are shown in U.S. dollars. Past performance is no guarantee of future results.

“A self-sustaining recovery would create a stronger tailwind for stocks and other risk assets, and should allow for a more sustained rebound in corporate profits.”

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Endnotes

Sources

All market data from Bloomberg, Morningstar and FactSet

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