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Weekly Investment Commentary

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Putting trade concerns and volatility in context: Ten points to consider

Volatility remained high last week as investors were buffeted by news stories about a possible trade war between the United States and China. Tensions escalated on Friday when President Trump instructed U.S. trade representatives to consider an additional $100 billion in tariffs. The S&P 500 Index fell a total of 1.4% for the week, but dropped nearly 5% from peak to trough.[1] Technology and industrials both fell more than 2%, while consumer-related sectors and income-oriented areas held up slightly better.[1] U.S. Treasury yields generally rose last week as the yield curve steepened.[1]

HIGHLIGHTS

- **Trade fears continue to dominate the markets. We think these issues will remain in the headlines for some time, and could represent a significant risk to the economy and financial markets.**
- **A possible slowdown in economic growth,however, may represent an even more serious risk. We expect the U.S. economy to reaccelerate, but the data bear close scrutiny.**
- **We think equity markets are in the midst of a consolidation phase and expect stock prices to remain volatile and range bound for some time.**

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Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.

Ten points to consider:

Most of the questions we're hearing from investors are about the seriousness of trade and tariff issues, other key risks and if we are near the end of the bull market. Following are 10 points we think are worth considering:

1) Trade issues represent a serious risk to the global economy and financial markets. President Trump has consistently indicated that he believes tariffs on imports are good for the United States, and he has surrounded himself with advisors who also generally support protectionism. The president has set his sights on China, and it appears that trade-related issues will be rattling the markets for some time. Furthermore, trade issues could spill over into broader geopolitical escalation between the U.S. and China.

Looking ahead, we expect both the United States and China to follow a dual strategy on trade. Publicly, leaders will engage in bellicose rhetoric and the headlines will raise threats of an escalating trade war. At the same time, we hope quiet negotiations will continue as the countries seek a compromise. As an example, the recently announced tariffs do not take effect until June, which gives the parties an opportunity to hammer out a deal. As with the steel and aluminum tariffs, this next round may wind up being less restrictive than originally announced.

2) It is important to keep current trade issues in context. In our view, tariffs are almost always a negative and effectively act as a tax that makes it more difficult for producers to interact with consumers. But the scope of the current issues remains relatively contained. So far, announced actions between the U.S. and China amount to less than $150 billion. As a point of comparison, U.S. tax cuts totaled $200 billion, Congress recently authorized $100 billion in additional spending, and we anticipate U.S. companies will repatriate close to half a trillion dollars in overseas profits. So far, the effects of fiscal policy appear to be overwhelming the impact of tariffs.

3) A possible slowdown in economic growth may be a more critical risk for stocks. Investors are focused on several downside risks: the mega-cap tech selloff, gradual central bank tightening, White House staffing turmoil and the ongoing Mueller investigation. But in our view, a potential period of economic weakness may be the most serious risk facing stocks. We think the U.S. is more likely facing a temporary soft patch than approaching the end of the expansion, but economic data bears watching.

4) Manufacturing remains solid but has slowed. The ISM Manufacturing Index fell from 60.8 in February to 59.3 in March.[2] March's number is still positive, but the drop coincides with other weakening data, such as retail sales.

5) The labor market remains in good shape, at least for now. Last week's labor market report showed a downturn from February to March.[3] Some issues may be weather- related, and the jobs market is still growing, but this is a trend investors should follow.

6) **We acknowledge downside economic risks but believe the U.S. economy is accelerating.** We believe U.S. real gross domestic product is likely to accelerate from the 2.5% pace in 2017 to 3% by the end of 2018.[4] We also expect 2018 growth to be driven more by capital spending and less by the consumer sector.

7) **Inflation appears to be slowly moving higher, which may add to market volatility.** Last week's employment data showed wage growth rose to a 2.7% year-over-year level.[3] Consumer price and producer price data released this week will be closely watched for signs of inflation acceleration. We think inflation is moving from "very low" to "low" and shouldn't yet be problematic. But rising inflation may create a headwind for equity valuations.

8) **We think stocks are in the midst of a consolidation and correction, but not nearing the end of the bull market.** Economic and corporate fundamentals remain decent, which leads us to believe that the bull market should continue. Additionally, the stress in the equity markets has not been echoed in credit markets, and volatility remains relatively low in other asset classes. This is a positive sign that may indicate stocks are in the midst of a regular bull market correction rather than something more serious.

9) **The presidential four-year cycle suggests volatility could remain elevated, but also points to a possible silver lining.** History is an imperfect guide, but cyclical trends can be instructive. Midterm election years have historically been the most volatile of the four-year presidential cycle.[5] Since 1962, midterm years have seen an average peak-to-trough decline of 18% for the S&P 500 Index.[5] In addition, these declines have historically represented strong buying opportunities. On average, from the low points during midterm years, the S&P 500 Index climbed 36% over the following 12 months.[5]

10) **Near term, we think it will pay to be cautious and tactical in this environment.** Since late January, stock prices have remained in a broad trading range of between 2,875 and 2,532 for the S&P 500 Index.[1] We think this trend will continue, and those levels may represent the high and low for several months and possibly for all of 2018.

As such, we think investors should approach markets with caution, but also be tactical: We think investors should look for opportunities to add to positions on weakness. And given that markets are near the low end of their trading range, now might be such a time. Additionally, we think it makes sense to take profits during times of strength. Over the longer term, we continue to have an optimistic view toward equities.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500 Index	-1.4%	-2.1%
Dow Jones Industrial Average	-0.7%	-2.6%
NASDAQ Composite	-2.1%	0.5%
Russell 2000 Index	-1.0%	-1.2%
Euro Stoxx 50	1.5%	-0.1%
FTSE 100 Index (U.K.)	2.4%	-1.5%
DAX Index (Germany)	1.1%	-3.2%
Nikkei 225 Index (Japan)	-0.3%	0.3%
Hang Seng Index (Hong Kong)	-0.7%	-0.3%
Shanghai Stock Exchange Composite Index (China)	-1.6%	-2.4%
MSCI EAFE	0.5%	-0.9%
MSCI Emerging Markets Index	-0.7%	0.7%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-0.1%	-1.5%
BofA Merrill Lynch 3-MonthTreasury Bill (cash)	0.0%	0.4%

Source: Morningstar Direct, Bloomberg and FactSet as of 6 Apr 2018. 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 indices are unmanaged and unavailable for direct investment.

"This looks like an environment where investors should be tactical: looking for opportunities to add to positions on weakness but also take profits during times of strength."

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1 Source: Morningstar Direct, Bloomberg and FactSet. 2 Source: Institute for Supply Management 3 Source: Department of Labor 4 Source: Bureau of Labor Statistics

5 Source: Strategas Research

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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