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Weekly Investment Commentary

10 December 2018

Volatility persists, but we retain a moderate pro-growth view

One week after posting their best weekly results of 2018, global stock markets fell sharply last week.[1] There was an intense focus on the inverted short end of the Treasury yield curve, which some took as a recessionary signal. The S&P 500 Index lost 4.6% last week, with defensive areas such as utilities holding up the best.[1] Treasury yields rallied across the curve in this risk-off environment, with the 10-year yield falling to levels not seen since early September.[1]

HIGHLIGHTS

- **Stocks sank sharply last week as investors questioned the strength of U.S. and global economic growth.**
- **We think growth will slow next year, but only moderately.**
- **As such, we think it makes sense for investors to remain cautiously optimistic toward risk assets in the year ahead.**

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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.

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Weekly top themes

1. ***The November employment report was solid and provided reason for the Federal Reserve to raise rates again this month.*** While jobs growth was a bit less than expected, unemployment remains low, and wage growth stayed at a cyclical year-over-year high of 3.1%.[2]

2. ***Manufacturing data in November was ahead of expectations.*** Surprisingly, the ISM Manufacturing Index improved last month, with orders, production and subcomponents all showing strength.[3]

3. ***We expect the pace of Fed rate hikes to slow in 2019.*** Should the Fed slow or pause its hiking campaign next year, that should help prevent financial conditions from tightening meaningfully further and could support more cyclical areas of the equity market.

4. ***A flatter (or even inverting) yield curve does not necessarily mean a recession or equity bear market is imminent.*** Last week the spread between the 2-year and 5-year Treasuries inverted for the first time since the financial crisis.[1] The 2-year/10-year spread, however, did not. That spread has inverted prior to every U.S. recession of the last 50 years.[4] Additionally, over the last 50 years, U.S. stocks have climbed an average of 15% in the 18 months following yield-curve inversions.[4]

5. ***Economic growth may slow next year, but we expect growth will remain decent.*** Real U.S. gross domestic product growth should be close to 3% in 2018.[1] We think that pace will slow to between 2% and 2.5% next year, which should be strong enough to keep the unemployment rate below 4% and provide a tailwind for corporate earnings.

6. ***Trade issues are likely to continue driving higher market volatility.*** The current 90-day timetable for the U.S. and China to resolve trade issues seems overly ambitious, especially considering there is a lack of clarity around any specific deal. We expect contentious trade issues will remain a negative theme well into next year.

7. ***Companies have not been heavily funneling tax reform savings into stock buybacks and dividend increases.*** Despite some claims to the contrary, recent data show just 25% of tax savings have been used for these purposes.[5]

Fears of a sharp economic slowdown in 2019 appear are overstated

The sharp selloff in risk assets and increase in volatility since early October appears to reflect a growing sense among investors that economic growth prospects could worsen considerably in 2019. To some extent, these concerns appear reasonable. Investors have been contending with weakening industrial activity in Europe and China, a worsening global trade environment, Brexit fears, the ongoing Italy/EU budget battles, concerns over Fed tightening and concern that U.S. growth is poised to slow.

We agree with the contention that economic growth is likely to slow next year, but we think it is premature to raise recession concerns and expect growth levels to remain in expansion territory. In the U.S., the labor market remains strong, and we think solid consumer spending and manufacturing activity should continue. The Fed is likely to slow its tightening campaign next year and remains highly focused on not causing economic damage. We also think political turmoil in Europe should remain relatively well contained and believe the evidence points to a soft landing in China.

As such, we expect U.S. and global economies will continue expanding at a moderate pace in 2019. Trade issues are likely to remain a threat, but growth should remain strong enough to support corporate earnings.

From an investment perspective, we think it makes sense to stick with a somewhat cautious but still constructive view. This implies an overweight to cash, a neutral position in equities and an underweight to bonds. Should we see non-U.S. economic and earnings growth start to improve more than U.S. growth levels, we could also see a shift in equity market leadership away from U.S. stocks.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-4.6%	0.3%
Dow Jones Industrial Avg	-4.4%	0.9%
NASDAQ Composite	-4.9%	2.0%
Russell 2000 Index	-5.5%	-4.6%
Euro Stoxx 50	-2.9%	-14.9%
FTSE 100 (UK)	-3.1%	-13.6%
DAX (Germany)	-3.5%	-20.8%
Nikkei 225 (Japan)	-2.2%	-3.2%
Hang Seng (Hong Kong)	-1.5%	-9.8%
Shanghai Stock Exchange Composite (China)	1.9%	-23.6%
MSCI EAFE	-2.3%	-11.0%
MSCI EM	-1.3%	-13.1%
Barclays US Agg Bond Index	0.9%	-1.0%
BofA Merrill Lynch 3-mo T-bill	0.0%	1.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 7 Dec 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.

"We think the global economy will expand at a moderate pace in 2019, supporting corporate earnings."

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