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Weekly Investment Commentary

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Equity markets sink as the near-term outlook grows cloudy

Stocks continued to decline last week, as a worsening trade dispute dominated the news. The S&P 500 Index fell 0.7% for the week, with industrials and technology both hurt by trade worries.[1] The financials sector was also weak, as banks were hit by a decline in interest rates.[1] Defensive areas of the market fared better, with REITs, utilities and consumer staples being the standouts.[1]

HIGHLIGHTS

- **Markets continue to be buffeted by trade issues, and we think uncertainty will persist for some time, causing continued risks.**
- **We see several positives, including an improving earnings outlook and still-easy monetary policy.**
- **For now, we have a neutral near-term view toward stocks, and think it will pay to be tactical in this environment.**

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.

10 themes covering trade, the Fed, the economy, earnings and politics:

1.) Markets seem caught between the negatives of escalating trade issues and the positives of accommodative monetary policy. We think trade tensions will ease somewhat, but risks are elevated. We also think easy monetary policy will help keep the global economy on an uneven recovery path.

2.) Trade issues appear to have taken a turn for the worse, and uncertainty is rising. Notwithstanding a late-week announcement from President Trump to lift aluminum tariffs on Canada and Mexico, trade issues remain problematic for the economy and financial markets. The president deferred a decision on auto tariffs for six months, but we would not be surprised to see that issue heat up again. Likewise, tensions between the U.S. and China remain elevated, and the odds of a deal seem elusive in the near-term.

3.) Trade tensions with China could cause more pain for corporate earnings. S&P 500 companies only generate 2% of their sales from China.[2] Nevertheless, a 25% tariff on all U.S. goods flowing into China could lower earnings per share by as much as 6% due to the risks to profit margins.[2] The impact could be lessened if companies pass through more costs to consumers and/or if they reroute their supply chains.

4.) We do not expect a rate cut by the Federal Reserve any time soon. While the Fed has eased off of its rate hikes, the prospects for a cut seem more elusive than the market expects. As long as wages are growing at or above a 3% annual pace, it's hard to envision the central bank actually reducing rates.

5.) On the positive economic side, consumer sentiment improved. The University of Michigan's consumer sentiment index climbed to 102.4 in May, a 15-year high.[3]

6.) But on the negative side, retail sales unexpectedly fell in April.[4] This suggests some slowing in consumer spending momentum.

7.) Corporate earnings have been troubled, but we expect to eventually see a recovery. While growth has slowed, we do not expect an end to the current earnings cycle any time soon, especially if we see a trade deal between the U.S. and China.

8.) U.S. companies are experiencing better earnings results than their global peers. This is particularly evident when it comes to Europe. U.S. companies should show first quarter growth of around 2.5%, compared to 0.5% in Europe.[5] Likewise, positive surprises in the U.S. are averaging 6% compared to 0.2% for Europe.[5]

9.) Regulatory challenges to large technology companies may be an issue in the run up to the 2020 election. The notion of breaking up large tech firms is gaining popularity among many Democratic presidential candidates. We don't expect any sort of substantive legislation before next year's elections, but the issue bears watching.

10.) We are also seeing more pressure on prescription drug pricing. This is likely to be a heavily debated issue in Washington over the next two years, and Senate Republicans are being hard pressed to hold the line on efforts to prevent legislative legislation that would lead to price reductions.

Considering both upside and downside risks, we are “boringly neutral” on stocks in the near term

At the beginning of the year, when stocks were still in the midst of a correction, the bears argued that the decline was pointing to a pending economic recession. That proved not to be the case. And the latest market setback is now being attributed to an escalation in the trade wars. We have long said that trade issues were a real threat to the economy and markets. While we think the current issues will fade over time (especially since neither the U.S. nor China benefits from the turmoil), the uncertainty hampers economic activity and causes corporate management teams to delay some spending plans.

Before the latest setback, markets appeared stretched and overbought, and we think investors were too complacent. As such, it’s no surprise to see a modest price decline. The key question is whether this is the forefront of a more serious correction or merely a brief pause in the market’s upward trajectory.

From a fundamental perspective, the big picture looks reasonably constructive. Corporate earnings expectations are recovering, credit markets remain mostly healthy, the labor market is solid, monetary policy is accommodative and interest rates remain relatively low. At the same time, we must acknowledge that the economic and market cycles are aging and risks are growing. And while valuations are not expensive, they are hardly cheap.

As such, we admit we have little conviction about the near-term direction of the market and have a somewhat boring neutral outlook. We remain constructive about the longer-term prospect for equities, but believe now is a time to be tactical and focus on careful stock selection, both in terms of what investors own and what they avoid.

2019 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-0.7%	15.0%
Dow Jones Industrial Avg	-0.6%	11.5%
NASDAQ Composite	-1.2%	18.3%
Russell 2000 Index	-2.3%	14.5%
Euro Stoxx 50	1.5%	13.6%
FTSE 100 (UK)	0.0%	11.4%
DAX (Germany)	0.8%	13.1%
Nikkei 225 (Japan)	-0.7%	7.7%
Hang Seng (Hong Kong)	-2.0%	8.5%
Shanghai Stock Exchange Composite (China)	-3.3%	15.0%
MSCI EAFE	0.2%	10.6%
MSCI EM	-3.6%	3.8%
Barclays US Agg Bond Index	0.3%	3.6%
BofA Merrill Lynch 3-mo T-bill	0.1%	0.9%

Source: Morningstar Direct, Bloomberg and FactSet as of 17 May 2019. 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.

“Now is a time to be tactical and to focus on careful stock selection, both in terms of what investors own and what they avoid.”

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1 Source: FactSet, Morningstar Direct and Bloomberg
2 Source: Goldman Sachs Research
3 Source: University of Michigan
4 Source: Commerce Department
5 Source: Credit Suisse 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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