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Weekly Investment Commentary

19 November 2018

U.S. stocks retreat amid trade and global growth concerns

U.S. equities finished lower last week, with the S&P 500 Index down 1.5% following big gains in the prior two weeks.[1] Consumer discretionary was the worst-performing sector, due to weakness in the retail group.[1] Technology also lagged with a pullback in hardware stocks, and energy was hampered by oil price weakness.[1] Only materials and REITs finished higher for the week.[1]

HIGHLIGHTS

- **U.S. stock prices fell last week, with most major sectors except materials and REITS ending lower.**
- **U.S.-China trade talks resumed, but remain a source of concern prior to a Trump/Xi meeting later this month.**
- **We expect volatility will remain higher than in recent years, but recession risks remain low and corporate earnings should still be above average.**

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.

Ten thoughts about the current and pending environment:

1.) Trade concerns remain in the headlines. The U.S. and China confirmed that trade discussions had resumed ahead of a widely anticipated meeting between President Trump and President Xi later this month. Trade remains a risk, but it seems the most likely scenario would be an agreement for the two leaders to keep talking.

2.) A lack of synchronized global growth calls into question the state of the global economy. Although U.S. economic growth should remain strong, both Japan and Germany revealed contractions in third-quarter growth this week, while China growth also continues to slow.

3.) Oil prices fell despite reports of supply cuts. Oil ended the week down nearly 6%, falling 20% from its October high.[1] This decline came despite comments from OPEC that it may reduce output by as much as 1.5 million barrels per day.

4.) The Fed continues on its rate path. In an interview this week, Fed Chair Powell stood by his "long way from neutral" comments made in early October, suggesting we may see an additional rate hike next month and additional hikes next year.

5.) Corporate credit markets start to show softness. Corporate credit held up relatively well during the October stock market volatility, but equity weakness is beginning to extend to credit markets, with those markets experiencing widening spreads.[1]

6.) Higher credit spreads, however, are not signaling recession. We believe those credit spreads that turned higher in the past month are largely company-specific, but we are watching them closely.

7.) Companies are struggling to pass along higher costs at the same time that U.S. economic growth may start to slow. As a result, we think companies with strong pricing power should perform relatively well.

8.) We expect volatility to remain high relative to the past several years. However, high volatility is unlikely to continue if recession risks remains low and corporate earnings continue to improve. At the same time, we do not expect volatility to decline until there is some positive movement in the U.S./China trade war.

9.) The equity correction is not likely to become a full-fledged bear market, but we do not think the corrective period is over.

10.) A friendlier environment for value stocks may be on the horizon. We think the market is likely to experience lower earnings growth and lower multiples over the next decade, which may bode well for value stocks.

In our view, the current combination of interest rates, inflation, jobs, wages and valuation information look generally good for stocks, but the near-term outlook is cloudy

- **Interest rates and inflation.** The yield curve is clearly flattening as the Fed gets further into a rate-hiking campaign, but it's still a comfortable distance from inverting. We think yields at the long end will rise, and expect the Fed has further room to move up as well. We estimate the fed funds rate won't exceed the neutral rate for another 6 to 12 months, after which monetary policy may turn restrictive.
- **Unemployment and wages.** The unemployment rate continues to fall, but we think net monthly job gains would have to fall to below 125,000 for the unemployment rate to stop declining. While we think wages may increase enough to shrink corporate profit margins, the pace is slow. Inflation expectations are not yet pressing the Fed to speed up.
- **Valuation.** Strong earnings gains bring the S&P 500 forward PE multiple back down to the 15 to 16 range from its January peak above 18.[1] We think other valuation measures like price-to-sales, price-to-book and price-to-cash flow are well below concerning levels also.

Combining these factors, we maintain our tactical view of a market weighting for equities, underweight bonds and overweight cash pending further developments.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	-1.5%	4.1%
Dow Jones Industrial Avg	-2.2%	4.9%
NASDAQ Composite	-2.1%	6.0%
Russell 2000 Index	-1.4%	0.6%
Euro Stoxx 50	-0.8%	-11.0%
FTSE 100 (UK)	-2.3%	-10.1%
DAX (Germany)	-0.9%	-16.7%
Nikkei 225 (Japan)	-1.8%	-3.3%
Hang Seng (Hong Kong)	2.3%	-9.7%
Shanghai Stock Exchange Composite (China)	3.4%	-22.2%
MSCI EAFE	-1.4%	-8.9%
MSCI EM	1.1%	-12.7%
Barclays US Agg Bond Index	0.5%	-2.0%
BofA Merrill Lynch 3-mo T-bill	0.0%	1.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 16 Nov 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.

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1 Source: FactSet, Bloomberg and Morningstar Direct

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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Nuveen | 730 Third Avenue | New York, NY 10017 | 212.490.9000 | nuveen.com