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Weekly Investment Commentary

22 October 2018

Investors remain uneasy, but this bull market should continue

Equity markets were mixed last week and experienced choppy trading in the wake of the previous week's strong selloff. While impressive earnings boosted the markets, worries about rising interest rates acted as a headwind. In the U.S., the S&P 500 Index ended roughly flat for the week, as defensive areas of the market outperformed and cyclicals generally fared worse.[1] The equity market selloff in China deepened, but hopes grew that the Chinese government may provide additional policy support.[1] Overall, there is a sense among many investors that we may not have seen the end of the correction, although fundamentals continue to look sound.

HIGHLIGHTS

- **Markets traded unevenly last week as investors continued to focus on the possibility of additional selloffs.**
- **Economic fundamentals look sound, although we think inflation risks are starting to rise.**
- **We expect the current cycle to continue and think there is still room for equity prices to climb.**

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.

Weekly top themes

1 ***Corporate earnings continue to look strong.*** Approximately 20% of S&P 500 companies have reported results, with more than 75% beating earnings expectations by an average of almost 4%.[2] Current trends suggest the third quarter will see revenue growth of 7%, earnings growth of 19% and earnings-per-share (EPS) growth of 21%.[2] Importantly, results are trending much stronger for cyclical companies compared to defensive areas: Revenues and EPS are on track to grow 10% and 23%, respectively, for cyclicals but only 5% and 9% for defensive sectors.[2]

2 ***Inflation pressures appear to be rising, which is pushing bond yields higher.*** In recent weeks, we have seen solid wage growth, more hawkish inflation comments from the Federal Reserve and signs of increasing tariff-related cost pressures.

3 ***Fiscal policy is promoting growth but also contributing to rising bond yields and inflation.*** The combination of deregulation, tax cuts and more federal spending have been helping economic growth and the stock market. On the downside, the ballooning federal budget deficit is prompting rising yields and inflation at the same time the Fed is raising rates.

4 ***President Trump's comments about Fed policy are contributing to political instability.*** The president's statement that Fed Chair Powell represents the single greatest threat to his reelection campaign calls into question the independence of monetary policy and creates an unprecedented market and political dynamic that could prompt additional volatility.

5 ***We see some clouds on the economic horizon.*** We think a strong corporate sector and solid consumer spending should cause economic growth to continue accelerating for the time being. Over the next 12 months, however, these factors could slow and be challenged by rising rates and inflation.

We see no signs of a near-term recession

Current market conditions appear typical of the later stages of an economic growth cycle: Investors are growing more concerned about rising bond yields and higher inflation while looking for signs that economic growth could slow down the road. This has resulted in periodic selloffs, followed by renewed buying when attention returns to strong current economic and earnings data.

It seems clear to us that the decades-long trend of falling bond yields has come to an end. The upward pressure on yields has been gradual for the most part. But yield spikes like those seen recently have triggered equity declines.

Bond prices are likely to remain under pressure, but we think there is still ample room for another rally in equity markets. Although the pace of corporate earnings growth is slowing in the U.S., earnings remain firmly in growth mode. And prospects for non-U.S. earnings look good, especially after a deceleration phase in 2018.

Over time, it is certainly possible (and perhaps even probable) that rising inflation will force the Fed to raise rates to the point that economic growth will begin slowing. We don't believe we are yet at that point. As such, we think the current economic cycle and equity bull market still have legs. We would also point out that the recent crunch in equity prices, combined with improving earnings, means that stock valuations have been improving over the last month.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	0.1%	5.1%
Dow Jones Industrial Avg	0.5%	4.8%
NASDAQ Composite	-0.6%	8.8%
Russell 2000 Index	-0.3%	1.4%
Euro Stoxx 50	0.2%	-9.4%
FTSE 100 (UK)	0.1%	-8.2%
DAX (Germany)	-0.1%	-14.3%
Nikkei 225 (Japan)	-1.1%	0.7%
Hang Seng (Hong Kong)	-1.0%	-12.0%
Shanghai Stock Exchange Composite (China)	-2.3%	-25.8%
MSCI EAFE	-0.1%	-7.2%
MSCI EM	-0.9%	-14.1%
Barclays US Agg Bond Index	-0.4%	-2.5%
BofA Merrill Lynch 3-mo T-bill	0.0%	1.4%

Source: Morningstar Direct, Bloomberg and FactSet as of 19 Oct 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

2 Source: Credit Suisse

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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