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Weekly Investment Commentary

15 April 2019

# Equity prices continue to rise, but a near-term pause may be likely

*Equity prices advanced again last week, marking three straight weeks of gains.[1] Some of the concerns over economic growth triggered by the inverted yield curve a few weeks ago appear to have faded, as economic data have trended stronger. Financials performed particularly well, as bank stocks were helped by a rise in interest rates.[1] Health care stocks, in contrast, underperformed as managed care stocks continue to be held back by possible regulatory risks in the run up to the 2020 elections.[1]*

## HIGHLIGHTS

- **Equity prices have risen over the last few weeks, as economic data have shown signs of improvement.**
- **Corporate earnings are likely to struggle and valuations for stocks seem fair. This may make it difficult for equity prices to advance notably in the near term.**
- **Nevertheless, we think both equity prices and bond yields will advance before the current cycle ends.**

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*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. ***Global economic growth has firmed over the last several weeks.*** The concerns about a global recession evident earlier this year have faded somewhat. Economic growth appears solid in most major regions and equity markets have continued to climb. With data showing signs of rebounding in the U.S. and China, our concerns are currently focused on Europe

2. ***The labor market is showing signs of strength following a weak February report.*** Last week's initial jobless claims were stronger than expected and the report marked the fourth week of declines.[2] While some data have been mixed, we think this jobs market continues to improve.

3. ***Inflation remains well contained.*** The March Consumer Price Index fell to a 13-month low of 0.2%, providing evidence that inflation still remains well below the Fed's target rate.[2]

4. ***We don't expect the Fed to move in either direction any time soon.*** For the Fed to resume rate hikes, central bankers would need to see an increase in inflation and a more notable improvement in global growth. For it to actually ease, the Fed would need evidence of a clear risk of recession. The U.S. economy remains between those two extremes.

5. ***The 2020 presidential election offers the possibility of tax increases.*** The large number of Democratic candidates have been talking about a range of possible tax increases, including raising the top marginal rate from 37% to 40%, adding to the number of tax brackets, increasing capital gains tax levels and, most prominently, calling for an increase in corporate tax rates from 21% to 25%.

6. ***The U.S./China trade debate has shown signs of improvement, but tensions between the countries are broader than trade issues.*** Trade disputes have cast a light on contentious issues, such as technology research, intellectual property ownership and cybersecurity.

7. ***U.S. equities may be due for a near-term pause.*** First quarter earnings results and forward guidance from corporate management teams haven't been great. The best investors can hope for is probably that companies stop cutting their estimates. At the same time, we think stocks are fairly valued, with the forward price-to-earnings ratio on the S&P 500 Index around 16x.[1] For stocks to rise notably in the near term, it would require either improving earnings or expanding valuations, neither of which looks likely.

## Stock prices and bond yields are both likely to move higher before the current cycle ends

Although equity prices have been climbing in recent weeks, investor skepticism remains high and ample cash sits on the sidelines waiting to be invested. Many investors believe we are approaching the end of the current economic cycle. They point to the sheer age of the current expansion and equity bull market, as well as fundamental factors such as the recent inversion of the Treasury yield curve.

In our view, this current cycle still has legs. We see the persistent weakness in trade and manufacturing beginning to reverse. And Fed policy remains quite easy, as central bankers do not want to put economic growth at risk. In fact, the Fed is targeting higher inflation, showing the unrestrictive levels of current policy.

Nevertheless, risks to the economy and market persist, such as growing geopolitical tensions and uncertainty over trade policy. Likewise, corporate earnings will almost surely struggle in 2019, especially year over year, since 2018 results were fueled by the effects of the December 2017 tax cuts.

Given this backdrop, we think stocks may struggle to retain traction over the near-term. But we believe economic growth is likely to improve modestly from here, so we expect that both equity prices and bond yields will rise before the current cycle ends. As such, we think stocks are likely to outperform Treasuries over the next 12 months.

### 2019 PERFORMANCE YEAR TO DATE

| | Returns | |
|---|---|---|
| | **Weekly** | **YTD** |
| S&P 500 | 0.6% | 16.7% |
| Dow Jones Industrial Avg | 0.0% | 14.0% |
| NASDAQ Composite | 0.6% | 20.7% |
| Russell 2000 Index | 0.2% | 18.0% |
| Euro Stoxx 50 | 0.8% | 14.1% |
| FTSE 100 (UK) | 0.5% | 15.2% |
| DAX (Germany) | 0.7% | 13.1% |
| Nikkei 225 (Japan) | 0.0% | 8.6% |
| Hang Seng (Hong Kong) | 0.0% | 16.0% |
| Shanghai Stock Exchange Composite (China) | -1.6% | 31.2% |
| MSCI EAFE | 0.3% | 12.7% |
| MSCI EM | 0.4% | 13.3% |
| Barclays US Agg Bond Index | -0.1% | 2.5% |
| BofA Merrill Lynch 3-mo T-bill | 0.1% | 0.7% |

Source: Morningstar Direct, Bloomberg and FactSet as of 12 Apr 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.

*"We expect both equity prices and bond yields will rise before the current cycle ends."*

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1 Source: FactSet, Morningstar Direct and Bloomberg

2 Source: Department of Labor

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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