

Investors Await Clarity on Tax and Spending Policies

Equity markets were mixed last week, with the S&P 500 Index down fractionally.¹ Investors grew more wary about President-elect Trump's increasing scrutiny of specific corporate policies and a possible push for higher tariffs. The health care sector suffered due to drug pricing concerns, while retail sectors were hurt by generally disappointing earnings results.

Forward Guidance Is Key for Earnings and Equity Prices

As the fourth quarter earnings season begins, we think earnings are improving, but we expect mixed results. We believe interest rates, the U.S. dollar, oil prices and wage rates will drive results over the course of 2017. For the current reporting quarter, we expect higher oil prices will benefit energy and related sectors, and think the stronger dollar will present a headwind for larger multinationals.

Furthermore, we are closely watching forward guidance. Investors will scrutinize earnings statements for hints about what corporate management teams expect in terms of possible tax reform, regulatory changes and economic growth. These factors are likely to drive capital spending, hiring plans and a range of other corporate actions that could affect equity prices.

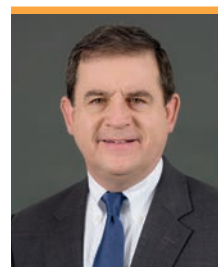
Overall, both consumer and business confidence appears high, and corporate earnings and economic growth should accelerate in 2017. This should produce tailwinds for stock prices, but gains are likely to be uneven and more company-specific compared to recent years.

Weekly Top Themes

- 1. Rising wage inflation brings positives and negatives.** Rising wages are good news for consumer spending, but they may drag down corporate profitability.
- 2. We expect action on the "Trump Agenda," but with little economic impact until 2018.** We expect the new president and Congress to aggressively move on tax reform and fiscal stimulus. Such legislation is complex and it will take time to take effect, so any results won't be felt until next year. Investors are hoping that fiscal stimulus will offset tighter monetary policy, allowing growth to accelerate. The risks are that the economy slows before fiscal stimulus can take effect or decreasing liquidity becomes a problem for financial markets.
- 3. Correlation between individual stocks is falling, possibly presenting opportunities for active managers.** According to Bernstein Research, the

KEY POINTS

- The post-election rally took a break last week as investors await corporate earnings news.
- We believe global economic growth will accelerate, providing tailwinds for equities and other risk assets.
- 2017 is likely to be a stock-pickers market, as we expect further diversion between individual securities.



Robert C. Doll, CFA

*Senior Portfolio Manager,
Chief Equity Strategist*

Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.

post-election environment produced the period of the lowest correlation between individual U.S. stocks since the height of the financial crisis (meaning the performance of any one stock was less affected by moves in the overall market). We expect this low-correlation environment to persist, which should make security selection and careful research critical to investment success.

Global Growth Should Improve, Helping Risk Assets

Investors remain highly attuned to potential changes in the political backdrop. Since the election, expectations for more pro-growth policies in 2017 have caused increases in equity prices, bond yields and the U.S. dollar. Sharply rising yields and a stronger dollar could present risks for stock prices, but bond yields and the dollar have retreated slightly in recent weeks. These moves probably reflect fading concerns over a faster-than-expected rate hike campaign by the Federal Reserve. The minutes from the Fed's December meeting show that policymakers expect growth and inflation to rise, but not at a pace requiring significant or rapid monetary tightening.

Outside of the United States, we think growth will be uneven but improving. The political environment in Europe is not supportive of growth, but we think this region will see some economic acceleration. Our outlook for China is mixed. Growth is slowing in the world's second-largest economy, as Chinese authorities enact reforms to make the economy less dependent on investment and more driven by domestic spending.

The U.S. and global economies were already improving before November's elections, and appear set to continue accelerating. Corporate earnings are also experiencing some tailwinds. The global political backdrop could create risks given rising populism around the world, but for now we think it makes sense to stick with a pro-growth investment stance. ■

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¹ Source: Morningstar Direct, as of 1/13/17

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.

2017 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500 Index	-0.1%	1.7%
Dow Jones Industrial Average	-0.4%	0.7%
NASDAQ Composite	1.0%	3.6%
Russell 2000 Index	0.4%	1.1%
Euro Stoxx 50	0.9%	2.0%
FTSE 100 (U.K.)	1.0%	1.6%
DAX Index (Germany)	1.1%	2.2%
Nikkei 225 (Japan)	1.0%	2.6%
Hang Seng (Hong Kong)	1.9%	4.3%
Shanghai Stock Exchange Composite (China)	-0.9%	0.9%
MSCI EAFE (non-U.S. developed markets)	0.8%	2.6%
MSCI Emerging Markets	1.7%	3.9%
Bloomberg Barclays U.S. Aggregate Bond (bonds)	0.2%	0.4%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	0.0%	0.0%

Source: Morningstar Direct and Bloomberg, as of 1/13/17. 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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