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Weekly Investment Commentary

23 April 2018

Stock prices rise, but investing is becoming more challenging

Investors continued to focus on a wide range of big-picture risks last week, including economic growth data, inflation, U.S. political turmoil, geopolitical issues and trade worries. The good news was that investors could also react to first quarter earnings results, which have started off quite strong. Markets rose early in the week before sinking on Thursday and Friday, as the S&P 500 Index climbed 0.5%.[1] The energy and industrials sectors were the best-performing areas, while consumer staples and technology lagged.[1] Treasuries also came under pressure as yields rose to their highest levels in years.[1]

HIGHLIGHTS

- **Equity markets remain exposed to a number of serious risks, including trade issues, rising bond yields and inflation, stress in the banking system and political turmoil.**
- **The good news is that corporate earnings continue to improve, which will be critical if stock prices are to rise.**
- **For now, we think the tailwinds for stocks are stronger than the headwinds, but we will need to see risks diminish before equities can break out of their trading ranges.**

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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.

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Weekly top themes

1 ***Trade risks have faded recently, but remain a threat.*** Investors appear more sanguine about several trade-related risks, including prospects for NAFTA and tariffs on steel and aluminum. Relations between the United States and China, however, remain a source of concern. We expect Washington and Beijing will eventually reach some sort of detente that avoids an escalating war of more tariffs and other punitive actions, but the outlook remains uncertain.

2 ***First quarter corporate earnings have been highly impressive.*** With approximately 20% of companies reporting, 81% have exceeded expectations by an average of 6.4%.[2] This compares to an average beat of 4.7% over the last three years, which underlies the strength of this quarter.[2] Much of the strength has come from reduced tax burdens: Earnings-per-share is on track to grow 23%, but would only be 16% were it not for the effects of lower taxes.[2]

3 ***Rising inflation represents a risk for financial markets.*** U.S. inflation data has been creeping higher, and we believe inflation will reach the Federal Reserve's stated target of 2% before the end of this year. While the increase should be gradual, higher inflation will likely contribute to equity market volatility and downward price pressure on bond markets.

4 ***Higher bond yields are becoming a reality.*** Equity markets have staged an impressive rally in recent weeks, climbing close to 5%, but appear to be losing steam.[1] We think some of this weakness is due to higher bond yields: The 10-year Treasury yield ended last week at 2.96%, its highest level since early 2014, while the 2-year yield reached 2.46%, its highest level since 2008.[1] As with inflation, higher yields will complicate the investing landscape.

5 ***Future equity price gains are likely to depend on rising corporate earnings.*** For the past six years, corporate earnings have improved while price/earnings levels have moved higher. This year, we expect earnings will continue to rise, but valuations should drop, or at best remain flat. This means that rising profits and earnings will be needed for stock prices to move higher.

Downside risks appear more prominent for bonds than for stocks

Equity markets have been buffeted by a number of credible threats so far in 2018. The dollar has lost value, trade tensions have escalated, global government bond yields have spiked and the LIBOR-OIS spread (the difference between the interbank lending rate and overnight indexed swap rate) has widened, which is a sign of stress in the banking system.

Global growth momentum is likely to downshift this year at the same time that inflation creeps higher and monetary conditions slowly become less accommodative. This looks to be a negative environment for many areas of the bond market, especially for government sectors. In contrast to movements in financial markets over the past several years, we expect bond yields will rise more meaningfully during risk-on phases. This will put increased downward price pressures on fixed income assets.

We believe these and other risks will continue to trip up equities, but shouldn't be enough to actually cause a bear market. At the same time, we think these risks will need to ease before stocks can regain their footing. So far, trends have been mixed: The dollar has consolidated losses since January and the LIBOR-OIS spread widening has paused, but trade risks remain and bond yields have started rising again.

The correction and consolidation in equity markets that began in early February has taken some froth out of the markets, and stock prices seem to have settled into a broad trading range. Equity volatility has remained elevated and that isn't likely to change, but the good news is that corporate earnings continue to improve.

For now, it appears that the tailwinds for stocks remain stronger than the headwinds, but given all of the possible downside risks, we do not expect equity prices to chart new highs any time soon. As such, this remains an environment in which investors will need to be tactical and more selective in their portfolios in order to find investment opportunities.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500 Index	0.5%	0.4%
Dow Jones Industrial Average	0.5%	-0.4%
NASDAQ Composite	0.6%	3.8%
Russell 2000 Index	1.0%	2.2%
Euro Stoxx 50	1.1%	2.7%
FTSE 100 Index (U.K.)	0.0%	0.9%
DAX Index (Germany)	0.4%	-0.7%
Nikkei 225 Index (Japan)	1.7%	2.7%
Hang Seng Index (Hong Kong)	-1.2%	1.7%
Shanghai Stock Exchange Composite Index (China)	-2.9%	-4.0%
MSCI EAFE	0.5%	1.1%
MSCI Emerging Markets Index	-0.1%	1.3%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-0.6%	-2.3%
BofA Merrill Lynch 3-MonthTreasury Bill (cash)	0.0%	0.5%

Source: Morningstar Direct, Bloomberg and FactSet as of 20 Apr 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: Morningstar Direct, Bloomberg and FactSet.

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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