

Equities Grind Higher as the Economy Continues to Muddle Through



WEEKLY INVESTMENT COMMENTARY

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U.S. equities advanced last week, with the S&P 500 increasing 1.10%.¹ For the month of July, the S&P gained 5.09%, and equities have increased 21.33% year to date.¹ Second quarter earnings season is nearly complete, and there has not been a material change in estimated earnings for the balance of the year or 2014. Revenues were slightly ahead of expectations, and earnings per share were approximately 3% higher than expected, annualizing at about \$110 per S&P 500 share.²

Waiting to Hit the Growth Accelerator

Earnings performance was skewed to financials that accounted for all of the earnings gains. The other 9 sectors combined had slightly negative earnings, according to FactSet analysis. Among the positive earnings surprises were cyclical sectors like technology, industrials and financials. Defensive sectors and those that generally benefit from inflation are not faring as well.²

We expect the U.S. economy to accelerate in the second half toward 2.5% to 3.0% GDP growth. We believe the labor market should continue to improve gradually as the number of employed workers increases at a rate similar to the first part of the year, despite the higher growth we anticipate. Consequently, we expect productivity to increase. Underlying inflation seems to have leveled out at a rate below the target of 2% set by the Federal Reserve. It appears QE3 will begin to gradually wind down after the September Fed meeting.

Weekly Top Themes

1. **Real GDP for the second quarter was relatively weak at 1.7% with nominal GDP of 2.4%.³** We continue to believe that pent up demand in cyclical sectors and a decline in the negative effect of sequestration will help growth trends.
2. **July monthly payroll employment disappointed versus expectations with an increase of 162,000 jobs.⁴** Previous data were revised lower, and the unemployment rate declined only because the employment participation rate dropped. Since QE3 started, the monthly average payroll growth has been roughly 200,000.
3. **The July ISM Manufacturing survey reported its biggest one month increase since 1996.⁵** Domestic final demand, particularly housing-related issues, were the biggest areas of strength.



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

4. **The Case-Shiller home price index is now up nearly 15% from its low in March 2012.**⁶ The overall figure follows from the recently reported 1.1% increase in May (10-city composite, seasonally-adjusted).
5. **The race to succeed Fed Chairman Ben Bernanke is led by Janet Yellen and Larry Summers.** It is unlikely either will suggest premature Fed tightening. Yellen could be the candidate of continuity and stability. Summers may be seen as the change candidate, with greater uncertainty regarding policy.

The Big Picture

We advocate a moderately pro-growth portfolio underpinned by a slowly improving global economy and reflationary policy support from G7 central banks.

Equities should be beneficiaries of growth and reflation tailwinds as earnings advance and investors gradually add risk exposure after a period of conservatively-based portfolio composition. In fixed income, yields should slowly trend higher in response to better growth conditions, resulting in poor total returns, with risks predominantly to the bearish side. The ongoing reversal in the prior commodity boom points to further price weakness until global growth is strengthened materially.

In our view, investors should consider an overweight stance on equities. Equities are poised to benefit from improving earnings, while rising yields imply a modest downturn for bond portfolios. On a sector basis, we favor cyclical sectors that should rebound as growth improves. ■

MAJOR WORLD ECONOMIES – POTENTIAL OUTCOMES

U.S.: The economy will continue to gain traction with GDP likely to expand nearly 3% over the coming year.

China: We remain proponents of a soft landing, anticipating 7% to 7.5% real growth over the next year.

Europe: It seems that the worst may be past, but any upturn will be weak and fragile.

Japan: The economic recovery resulting from aggressive reflation should continue.

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	1.10%	21.33%
MSCI World Ex U.S.	1.19%	11.12%
MSCI Emerging Markets	-0.60%	-7.62%

Source: Morningstar Direct, as of 8/2/13. 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.

For more information or to subscribe, please visit nuveen.com/weekly-commentary.



¹ Source: Morningstar Direct, as of 8/2/13. ² Source: FactSet Earnings Insight, 8/2/13, <http://www.factset.com/earningsinsight>. ³ Source: Bureau of Economic Analysis, "National Income and Product Accounts Gross Domestic Product, Second Quarter 2013 (advance estimate)," July 31, 2013, <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>. ⁴ Source: Bureau of Labor Statistics, "The Employment Situation - July, 2013," August 1, 2013, <http://www.bls.gov/news.release/emp/sit.nr0.htm>. ⁵ Source: July 2013 Manufacturing ISM Report On Business,[®] August 1, 2013, <http://www.ism.ws/ismreport/mfgrob.cfm>. ⁶ Source: S&P Dow Jones Indices, "Home Prices Continue to Increase in May 2013 According to the S&P/Case-Shiller Home Price Indices," July 30, 2013, <http://us.spindices.com/index-family/real-estate/sp-case-shiller>.

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. The **MSCI World Index ex-U.S.** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets minus the United States. The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

RISKS AND OTHER IMPORTANT CONSIDERATIONS

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