Cyclical and Emerging Market Strength May Be Pointing to Better Growth

NUVEEN ASSET MANAGEMENT

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Last week U.S. equities advanced as the S&P 500 increased by 1.3%.[1] We have been amazed by the market's ability to continue to rally in an environment in which sales growth has been anemic and earnings gains have been largely based on companies' abilities to manage margins and utilize financial engineering.

Awaiting the Self-Reinforcing Expansion

Despite a lackluster economic and profit backdrop, there are growing expectations that the Fed will continue with open liquidity taps, intensifying the search for yield and forcing investors into equities. It seems that corporations are taking advantage of this yield hunger by issuing debt, levering up their balance sheets and returning cash to shareholders. A greater risk for the global economy appears to be deflation. While quantitative easing by the Fed and other central banks may eventually result in higher final goods prices, a more immediate result may be higher prices for risky financial assets, especially equities.

Another critical issue is whether growth will falter again. We believe the chance of a growth relapse is relatively low. The housing recovery alone is only a small plus for the overall economy. Its effect on consumption, government revenues, improved collateral values, and a slowly-healing monetary transmission mechanism will help create a self-reinforcing expansion, although we believe the recovery could remain less vigorous than in past cycles. Until housing reached its trough, the economy could not begin to recover, and now further housing price gains and sales will continue to provide a modest economic tailwind.

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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.

Weekly Top Themes

1. **Initial filings for jobless claims declined again, setting a new low for the cycle:**[2] The jobless claims fell by 4,000 for the week ended May 4, 2013. Since claims have now fallen three weeks in a row, this continues to send a reassuring signal about the health of the labor market. If claims can hold near current levels or fall further, we would anticipate a solid increase in private sector job creation.

2. **The Fed's latest Senior Loan Officer Opinion Survey showed easing in lending standards and increases in demand for lending categories:**[3] The report was somewhat of an improvement, but reflects continued modest economic growth. The Fed survey tends to have a one-year lead on S&P revenues.

3. **The macro tail risk from Washington continues to decline as the debt ceiling breach has moved from July to most likely October:**[4] The improvement is a result of higher than expected receipts from the expiration of the payroll tax credit and the tax raises associated with the fiscal cliff deal. This is likely to provide a much longer runway than was previously anticipated, and U.S. political issues should have less of an impact during the second and third quarters.

The Big Picture

We believe the market is suggesting improvement in the economy, not only by appreciation but also by internal action. In our opinion, factors generally associated with a cyclical upswing, such as beta and leverage, have begun to outperform for the first time this year, while those offering stability are starting to lose some steam. The next part of the story unfolded at the sector level two weeks ago, when cyclicals began to outperform while defensive sectors started to falter. For example, information technology, energy, financials, industrials and materials are all outperforming the broad market while consumer staples, utilities, health care and telecom are lagging.[5]

For equities, we believe the trend continues to be upward. For the bond markets, we expect a continued upward tilt in yields. Commodities are likely to continue to struggle until global economic activity is more robust. Higher dividend stocks and defensive stocks have become relatively expensive, and in our view many cyclical companies and emerging equity markets offer good value in a low growth world. We expect this shift to continue only if global economic growth improves, and more evidence is needed for those trends to continue.

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	1.29%	15.43%
MSCI World Ex U.S.	0.76%	10.35%
MSCI Emerging Markets	0.88%	0.41%

Source: Morningstar Direct, as of 5/10/13. 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.

"Higher beta and leverage along with cyclicals and emerging markets are just beginning to outperform."

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Beta is a measure of the volatility of a portfolio relative to the overall market. A beta less than 1.0 indicates lower risk than the market; a beta greater than 1.0 indicates higher risk than the market. **Leverage** is created when a portfolio has investment exposure (both reward and/or risk) equivalent to more than 100% of the investment capital.

1 Source: Morningstar Direct, as of 5/10/13. **2** Source: Bureau of Economic Analysis, "The Employment Situation," May 3, 2013, http://www.bls.gov/news.release/empsit.nr0.htm. **3** Source: The Federal Reserve Board, "The April 2013 Senior Loan Officer Opinion Survey on Bank Lending Practices, April 2013, http://www.federalreserve.gov/boarddocs/snloansurvey/201305/default.htm. **4** Source: New York Times, "House Vote on Debt Ceiling Gives Priority to Creditors," May 9, 2013, http://www.nytimes.com/2013/05/10/us/politics/house-votes-to-give-creditors-priority-if-debt-ceiling-is-breached.html. **5** Source: FactSet, as of 5/10/13.

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.

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