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Weekly Investment Commentary

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Stocks could be due for another near-term setback

Stocks sank last week amid some horrific retail sales data and Federal Reserve Chair Jerome Powell's downbeat economic assessment. Investors may have been ready to lock in some recent gains, suspecting that equity prices may have risen too fast since their late-March low. Energy stocks fared the worst following a multi-week rally, and REITs and industrials also suffered. Only health care finished in positive territory.[1]

HIGHLIGHTS

- **Economic data continues to break negative records, but we think April will mark the low point for this recession.**
- **Upside and downside risks for stocks appear fairly well balanced. Over the short term, we think the negatives could win out, meaning that equity prices could be vulnerable to additional downside action.**
- **But over the long term, we expect markets will experience more solid footing once investors see more clarity about the state of the economy.**

Robert C. Doll, CFA
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.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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10 observations and themes

1) The Fed provided a dire forecast for the economy, indicating monetary policy will remain very easy for some time. In particular, Chairman Powell noted, "the path ahead is both highly uncertain and subject to significant downside risks." He also highlighted the ways a deep and long recession could harm long-term growth considerably even after the actual recession ends.

2) We do not expect to see negative interest rates in the U.S. Chairman Powell said as much last week. The Fed will engage in continued quantitative easing, buying more corporate bonds to narrow credit spreads and increase market liquidity**.**

3) The coronavirus pandemic is disproportionately affecting those of retirement age, which could influence how parts of the economy are re-opened. According to the CDC, the average age of those who have died is 76, with 80% of all deaths in America coming from those over 65.

4) Even if infections rise, it will be politically very difficult to "re-lock down" the economy. The original case for economic closing was not to wait for the virus to be eradicated, but rather to slow down the pressure on the health care system and buy time to develop more testing and treatment. Americans seem increasingly determined to re-open the economy.

5) We continue to think April will mark the low point for the recession. Retail sales collapsed a record 16.4% last month, with only online retails avoiding the pain.[2] We expect to see economic data start to improve in May as parts of the economy begin to re-open.

6) Credit markets remain stressed, but are improving. Since the Fed announced support for credit markets in late March, absolute yields have declined and credit spreads have narrowed. Spreads still remain wide by historic standards, but conditions are slowly getting better.[1]

7) The next fiscal stimulus package is likely weeks or months away. The $3 trillion package passed by the House has virtually no chance of passing in the Senate, although there is a consensus in Washington that more stimulus is needed. We expect a final package in the neighborhood of $1 trillion that could include state and local government support, additional health care funding, some business liability protections, additional unemployment insurance and possibly additional direct payments to individuals.

8) U.S./China relations will likely continue worsening in advance of the November elections. The follow-through on the Phase-One trade deal seems in jeopardy, and U.S. animosity toward China is growing as politicians on both sides of the aisle are blaming China for an insufficient response to the virus.

9) Corporate earnings are likely to continue struggling. Close to 150 of the S&P 500 companies have suspended earnings guidance, nearly 100 have stopped stock buybacks and nearly 50 have actually cut dividends.[3]

10) Inflation could start to rise by 2022. The aggressive and coordinated expansion of monetary and fiscal policy is designed to be reflationary. Depending on how long this stimulus continues, it could disrupt the long-term disinflationary forces such as technological and productivity improvements that have taken hold over the last decade. We may start to see signs of inflation next year.

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Risks to stocks seem balanced, but we have a modestly positive long-term view

When markets bottomed on March 23, we believed that point could be the low for the cycle. When stocks subsequently climbed 25%, we started arguing that markets were ahead of themselves. Equities have since climbed another 10% and subsequently pulled back 5%.[1] So where are markets heading from here?

Upside and downside risks appear fairly well balanced. The bull case: 1) The Fed is easing aggressively. 2) More fiscal stimulus is likely. 3) The infection rate is falling and test capabilities are rising. 4) We expect better or at least less bad economic data from here. 5) Investors have few alternatives to stocks. And the bear case: 1) The magnitude of economic damage will take years to fix. 2) More earnings disappointments are likely. 3) Valuations are less attractive than they were three months ago. 4) An additional surge in infections is very possible. 5) Bear markets associated with a recession usually last longer than four weeks.

Over the near-term, we are concerned that investors may be looking past this list of negatives, and we think stocks could be vulnerable to additional bad news. As such, we think additional corrective action is probably likely. Over the long-term, however, we believe the positives will outweigh the negatives. Stock prices could gain ground when we have more clarity around the state of the economy. At that point, we expect investors will begin to price in prospects for a sharper economic recovery at the same time the Fed remains committed to promoting growth. This could cause a rotation away from the more defensive areas of the market that have been outperforming and into more economically sensitive cyclical areas.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	-2.2%	-10.7%
Dow Jones Industrial Avg	-2.6%	-16.3%
NASDAQ Composite	-1.2%	0.8%
Russell 2000 Index	-5.4%	-24.3%
MSCI EAFE	-3.2%	-20.6%
MSCI EM	-1.1%	-18.6%
Bloomberg Barclays US Agg Bond Index	0.3%	4.9%
BofA Merrill Lynch 3-mo T-bill	0.0%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 15 May 2020. 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.

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1 Source: Bloomberg, Morningstar and FactSet

2 Source: Census Bureau

3 Source: Bank of America Merrill Lynch Research

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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