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Weekly Investment Commentary

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Market gyrations will likely continue for some time

Markets were volatile again last week, although this time the volatility skewed to the upside. Geopolitical issues remained in focus, with investors watching ongoing U.S./China trade developments and escalating tensions in Syria. Strong corporate earnings were also in the news, which helped lift equity prices. For the week, the S&P 500 Index climbed 2.0%.[1] Commodity-related sectors led the way, while technology was also a standout.[1] Income-oriented sectors fared the worst last week.[1]

HIGHLIGHTS

- **Trade tensions may be easing, which should allow investors to return their focus to economic and market fundamentals.**
- **Economic growth may have hit a soft patch, but we expect conditions to improve in the coming months. At the same time, corporate earnings growth has remained strong.**
- **This should create positive conditions for equities, but we expect market volatility to persist.**

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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.

Weekly top themes

1. ***Economic data appears to have hit a soft patch.*** Recent U.S. employment readings were worse than expected, while global manufacturing levels trailed off. The University of Michigan's Consumer Sentiment Index fell from 101.4 to a three-month low of 97.8 in a preliminary April reading.[2] We expect economic data to pick up in the coming months.

2. ***First quarter earnings results are starting off strong.*** Expectations for first quarter growth have risen from 12.2% at the beginning of the year to 18.5%, largely due to corporate tax cuts.[3] The closely-watched banking sector started off mixed, with Wells Fargo and PNC showing disappointing results and JP Morgan and Citigroup exceeding expectations.

3. ***Corporate free cash levels remain high.*** Companies are enjoying extraordinary levels of liquidity. As one measure, there have been more than 3,000 announced corporate deals including mergers and acquisitions over the past four years totaling $17 trillion.[4]

4. ***The regulatory environment remains a positive, for now.*** The Trump Administration has eased regulations across many industries, which has been a tailwind for corporate earnings and equity prices. The focus is now on the technology sector, particularly the scrutiny faced by Facebook and Amazon. It is too early to tell if regulations will increase, but it seems clear that large tech companies are facing significant public relations issues.

5. ***The federal deficit is becoming a more significant risk.*** Tax reform and the recent spending bill will contribute to higher deficit levels. The Congressional Budget Office is estimating the deficit will rise to $1 trillion in 2020, and we wouldn't be surprised if that level is reached next year. Rising deficit levels may force a contraction in federal spending in the coming years.

6. ***An environment of volatility and rising interest rates may be good for active equity management.*** Our experience suggests that when interest rates rise, equity market volatility also rises. These conditions can create sector and security dispersions that allow for tactical investment opportunities. According to one study, active U.S. large cap equity funds have, on average, outperformed their benchmarks by over 200 basis points since interest rates bottomed in July 2016.[5] Looking ahead, we expect a good environment for active equity strategies.

If trade issues fade, inflation risks remain

Investor attention remains focused on trade issues. Tensions eased somewhat last week, as Chinese officials indicated they may be open to negotiating resolutions. It is possible that the Chinese government may make some concessions that would allow President Trump to claim a political win that wouldn't disrupt global trade. Should tensions ease further, we think investors will resume focusing on economic developments, which would likely mean that they will start paying more attention to inflation.

The Federal Reserve noted last week that it expects inflation to hit its 2% target in 2019. We think there is a good chance inflation will reach that level this year. The latest reading of the core Consumer Price Index showed inflation has accelerated to 2.1% year over year and we expect it may reach 2.5% by the end of 2018.[6]

Such a backdrop suggests that interest rates and bond yields will continue to move higher in both the United States and around the world. In our view, investors in general remain overly complacent about inflation risks, especially when it comes to the bond market. Bond yields remain quite low and are pricing in an environment of slow growth and near-zero inflation. We believe government bond yields remain lower than they should be given the economic backdrop, and we expect yields to rise in the years ahead.

Volatility is likely to continue, but equity tailwinds remain

Higher levels of inflation also represent a possible risk for equities, but one we expect stock markets will be able to overcome. Decent economic growth and strong corporate earnings levels bode well for equity markets, especially if and when trade worries begin to fade. A modest and slow increase in inflation and interest rates shouldn't be enough to derail the long-running equity bull market.

Over the near-term, markets may remain in a consolidation phase, given all of the economic and political crosscurrents. A combination of reasonable valuations, fading trade fears, still-negative sentiment, good earnings results and successful tests of recent lows means we believe markets may make a run toward the higher end of the current trading range (around 2,750 to 2,800 for the S&P 500). However, downside risks also exist, and it may take some time before equity markets are ready to post new highs.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500 Index	2.0%	-0.1%
Dow Jones Industrial Average	1.8%	-0.9%
NASDAQ Composite	2.8%	3.2%
Russell 2000 Index	2.4%	1.3%
Euro Stoxx 50	1.8%	1.6%
FTSE 100 Index (U.K.)	2.4%	0.8%
DAX Index (Germany)	2.2%	-1.1%
Nikkei 225 Index (Japan)	0.7%	1.0%
Hang Seng Index (Hong Kong)	3.2%	2.9%
Shanghai Stock Exchange Composite Index (China)	2.6%	-1.1%
MSCI EAFE	1.5%	0.6%
MSCI Emerging Markets Index	0.7%	1.5%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-0.2%	-1.7%
BofA Merrill Lynch 3-MonthTreasury Bill (cash)	0.0%	0.4%

Source: Morningstar Direct, Bloomberg and FactSet as of 13 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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For more information or to subscribe, please visit nuveen.com.

1 Source: Morningstar Direct, Bloomberg and FactSet.

2 Source: University of Michigan

3 Source: Strategas Research

4 Source: ISI Evercore

5 Source: Wells Fargo Research

6 Source: Labor Department

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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