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Weekly Investment Commentary

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Markets appear to be in a correction (not bear market) phase

Last week, investors shifted the focus from worrying about missing out on the ongoing rally to concerns that equities were overbought. There were a number of issues for investors to ponder, including an ongoing complicated political backdrop, earnings reports and economic news. The main focus, however, was on sharply rising bond yields, which rattled equity markets and caused a notable decline. The S&P 500 Index fell 3.8% for the week.[1] Despite the magnitude of the decline, the drop was orderly and only took market values back to levels of a couple of weeks ago.[1] Losses were broad-based, with relative outperformers including banks, airlines and telecommunications companies.[1]

HIGHLIGHTS

- **A sharp rise in bond yields triggered the start of a corrective phase for stocks. We think yields are likely to continue rising, which could put additional pressure on equity markets.**

- **For equities, we expect more volatility over the short-term, a continuation of the bull market over the medium-term and generally lackluster returns over the long-term.**

Robert C. Doll, CFA

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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. ***January's employment report pointed to improving growth and rising inflation.*** New jobs growth came in at a higher-than-expected 200,000, while unemployment was unchanged.[2] The biggest news was that average hourly earnings were up 0.3% for the month and 2.9% year-over-year, which is the largest increase since 2009.[2] The tightness of the labor market appears to finally be creating wage acceleration.

2. ***Earnings continue to come in strong.*** With 42% of S&P 500 companies reporting, 81% have exceeded estimates, the highest in seven years.[3] At the same time, 75% have increased their fiscal year 2018 earnings-per-share projections.[3]

3. ***U.S. political confusion remains a market risk.*** President Trump's State of the Union address was noted for its calm tone, but no new policies were outlined in any detail. Investor attention is focused on this week's expiration of the current continuing budget resolution and the likelihood of further showdowns.

4. ***Bond yields are likely to continue to rise unevenly.*** The 10-year Treasury yield advanced 17 basis points last week alone, and is up 42 basis points since the start of the year.[1] In our view, nearly all key indicators point to a high likelihood of continued increases: Treasury supply is growing due to rising deficits, climbing inflation, improving economic growth, tightening monetary policy and rising global rates. We could see a pause in the advance and/or a near-term decline, but the long-term direction for rates appears to be up.

5. ***Stocks appear fairly valued, but we expect market sloppiness to continue.*** Equity markets still enjoy a strong fundamental backdrop of solid global growth and strong earnings. Monetary policy and inflation are shifting but do not yet represent headwinds. The problem for stocks right now is that interest rates appear to have risen too high, too quickly. With the S&P 500 Index around 2,800, we think equities are fairly valued given earnings prospects. This means we believe prices can continue to advance, but volatility will be higher than in recent years.

What will drive stock prices? The answer depends on the time frame.

In our experience, many different factors affect stock prices. Over the short term (weeks and months), technical factors and sentiment tend to drive returns. Over a one- or two-year time horizon, economic and business cycle developments have usually been the most important factors. And over the long term (five years and beyond), valuations have historically been the key determinant of prices.

Sometimes these three sets of factors align. At the start of the current bull market in March 2009, for example, sentiment had hit extreme lows, economic data was finally turning positive, the Federal Reserve launched its quantitative easing program and valuations had dropped to extraordinarily cheap levels.

Unfortunately, it looks more complicated today. From a technical perspective, prices appear to have gotten ahead of themselves. The cyclical outlook, however, still looks good given that economic and earnings growth continues to improve. And valuations appear full, although not excessive.

This complicates the outlook for stocks. Equity markets continue to look vulnerable to near-term corrective action, and the recent spike in bond yields proved to be a perfect catalyst for sparking a consolidation. Over the medium term, we think prices still have room to rise, but also expect increased volatility. And for the long term? Returns will probably be lackluster compared to the last decade, meaning investment selectivity should grow in importance.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500 Index	-3.8%	3.4%
Dow Jones Industrial Average	-4.1%	3.3%
NASDAQ Composite	-3.5%	4.9%
Russell 2000 Index	-3.8%	0.8%
Euro Stoxx 50	-3.0%	4.6%
FTSE 100 Index (U.K.)	-3.1%	1.4%
DAX Index (Germany)	-3.9%	2.7%
Nikkei 225 Index (Japan)	-3.0%	4.5%
Hang Seng Index (Hong Kong)	-1.7%	8.9%
Shanghai Stock Exchange Composite Index (China)	-2.4%	8.1%
MSCI EAFE	-2.7%	3.6%
MSCI Emerging Markets Index	-3.3%	6.3%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-0.9%	-1.8%
BofA Merrill Lynch 3-MonthTreasury Bill (cash)	0.0%	0.1%

Source: Morningstar Direct, Bloomberg and FactSet as of 02 Feb 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.

“Equity prices still have room to rise, but market conditions are likely to remain sloppy.”

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1 Source: Morningstar Direct, Bloomberg and FactSet. 2 Source: Bureau of Labor Statistics 3 Source: J.P. Morgan 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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