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Weekly Investment Commentary

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After a 10% correction, 10 thoughts about where we are heading

The initial market pressure that began two Fridays ago intensified last week, driving stock prices sharply lower amid intensely rising volatility. What started as concerns about overvaluation, emerging inflation threats and rising bond yields spiraled into a near-panic selloff as technical and structural market conditions exacerbated the slide. The Dow Jones Industrial Average experienced two separate 1,000 point declines last week, the S&P 500 500 Index lost 5.1% for the week and has now declined 12% from peak to trough.[1] While we think the worst of the correction may be behind us, messy market conditions may continue. And the long-term outlook is growing more complicated.

HIGHLIGHTS

- **We believe the worst of the correction may be over, but also think we could see additional sharp swings in the weeks to come.**
- **Fundamentals remain strong for the economy and for equity markets.**
- **We think equities will see gains for all of 2018, but investing conditions are growing more complicated.**

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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 ***The recent spikes in volatility have been due in part to technical market factors.*** As markets started to fall, bid/ask spreads widened and highly leveraged low-volatility strategies were forced to unwind.[1] In our view, this accelerated selling and contributed to the panic-like conditions early in the week.

2 ***Rising inflation pressures could act as an ongoing headwind for stocks.*** Improving wage growth was one catalyst that sparked the current correction. We expect this trend will continue putting upward pressure on inflation and bond yields. A combination of tax cuts and significant federal spending increases may accelerate these developments.

3 ***Last week's budget deal removes short-term uncertainty from the markets, but could cause longer-term issues.*** The package will add significant additional short-term stimulus and boost defense spending, which could cause an increase in both economic growth and inflation. It also makes the nation's troublesome fiscal problems even worse. Additionally, the spending package greatly reduces the risk of another budget fight, but probably eliminates any chance of an infrastructure deal.

4 ***Despite the market turmoil, economic fundamentals remain sound.*** Leading indicators and corporate earnings trends point to a continuation of the economic expansion and bull market. Warning signs to the contrary would include widening credit spreads and/or tightening financial conditions, but those have not materialized.

5 ***Corporate earnings continue to improve.*** With more than 80% of S&P 500 companies reporting results, earnings-per-share are up about 15% and sales are up in the high single-digits.[2] At this point, 81% of companies are beating earnings expectations, the highest level in eight years.[2]

6 ***The selloff has modestly reduced equity valuations.*** The S&P 500 forward price-to-earnings ratio had climbed as a high as 18.4 when the market peaked in mid-January.[1] As of Friday's close, it had fallen to 16.3, near where it was two years ago when markets experienced the early-2016 correction.[1]

7 ***Despite additional declines late last week, market technicals improved.*** After the Monday/Tuesday selloff, markets retraced before plunging again on Thursday into Friday morning.[1] Although price levels fell further late in the week than they did earlier, technical conditions were stronger: Volume was lower, we saw fewer 52-week lows and a fewer number of stocks declined.[1] We think these are positive signs.

8 ***Double-digit market corrections are a normal part of bull markets.*** The S&P 500 has more than quadrupled in price since it bottomed at 666 in March 2009.[1] During that same time, we have seen five different double-digit corrections: 17% in 2010, 22% in 2011, 10% in 2014, 16% in 2016 and (as of now) 12% in 2018.[1]

9 ***We believe this correction is close to its low in price terms, but markets probably need time to digest and repair.*** In other words, we think investors should respect this correction, but not fear it. The economy is solid, earnings are improving, financial conditions are sound, and corporate balance sheets look healthy. We believe these fundamental factors should eventually drive stock prices higher.

10 ***We still believe stock prices will rise for all of 2018.*** Our fair-value target for the S&P 500 this year has been and remains around 2,800. That would imply around a 7% total return for the year.[1] We also believe that valuation levels will be lower by the end of the year compared to the beginning due to higher interest rates and inflation.

This correction may continue, but positive signals remain encouraging

For much of the past year, we have been cautioning that market volatility was too low and a consolidation or correction could come at any time. It appears it finally happened with a bang, driven primarily by inflationary pressures and a spike in bond yields.

While some of the associated technical market factors may prove to be transitory, investors and financial markets may have to adjust to a new reality of higher interest rates and rising inflation. These developments are likely to cause additional near-term volatility in the weeks ahead, and we would not be surprised to see more sharp back-and-forth movements in stock prices.

The good news, however, is that we see no real signs that the economy is headed for recession or that earnings are poised to retract. Without that happening, it is hard to see how a lasting bear phase for stocks could emerge.

The investment landscape is shifting and growing more challenging

Importantly, however, we also do not believe we will return to the low-volatility, relentlessly rising market environment that investors enjoyed in 2017. The era of moderate economic growth, rising profit margins, low or falling inflation and hyper-accommodative monetary policy is now over. In its place, we are seeing stronger and more durable economic growth, rising bond yields, higher inflation and slowly tightening monetary policy.

This isn't a bad environment for stocks, but it is more complicated. This backdrop is likely to put more pressure on equity valuations and contribute to higher levels of volatility (as we saw last week). As a result, we think investors should expect lower long-term returns and higher volatility. This is typical of later stages of an economic expansion and equity bull markets. And while it doesn't mean gains are finished, it does mean investors may have to become more selective.

2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500 Index	-5.1%	-1.8%
Dow Jones Industrial Average	-5.1%	-1.9%
NASDAQ Composite	-5.0%	-0.3%
Russell 2000 Index	-4.5%	-3.7%
Euro Stoxx 50	-7.5%	-3.3%
FTSE 100 Index (U.K.)	-7.2%	-5.9%
DAX Index (Germany)	-7.2%	-4.8%
Nikkei 225 Index (Japan)	-6.7%	-2.5%
Hang Seng Index (Hong Kong)	-9.5%	-1.4%
Shanghai Stock Exchange Composite Index (China)	-9.6%	-2.2%
MSCI EAFE	-6.2%	-2.8%
MSCI Emerging Markets Index	-7.1%	-1.3%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	-0.1%	-1.9%
BofA Merrill Lynch 3-MonthTreasury Bill (cash)	0.0%	0.1%

Source: Morningstar Direct, Bloomberg and FactSet as of 12 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.

"We believe this correction is close to its low in price terms, but also that markets may continue to be messy for a while."

For more information or to subscribe, please visit nuveen.com.

1 Source: Morningstar Direct, Bloomberg and FactSet. 2 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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