Despite Setbacks, the Political Backdrop Can Support Growth

NUVEEN ASSET MANAGEMENT

WEEKLY INVESTMENT COMMENTARY

APRIL 3, 2017 | VOLUME 5.14

Following their worst week of the year, U.S. stocks rebounded last week. Investor sentiment was buoyed by a strong consumer confidence report, and the S&P 500 Index managed a 0.8% gain.[1] Small cap stocks and cyclical sectors led the way, and the U.S. dollar advanced.[1]

Key Points

- Stock prices bounced back last week, thanks in part to the strongest consumer confidence level in nearly 17 years.
- Investors are focused on political risks, but we think potential for a near-term economic disappointment is a bigger issue.
- In any case, we remain constructive toward equities and other risk assets over the medium- and long-term.

Weekly Top Themes

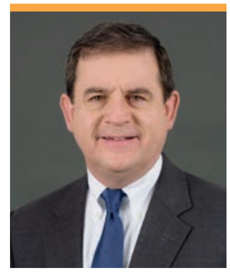
1. **March consumer confidence soared to its highest level since December 2000.** The Conference Board's Consumer Confidence Index hit 125.6, its highest level in nearly 17 years.[2] We expect rising confidence to boost real consumption levels in the months to come.

2. **Tax reform is key to the pro-growth Trump agenda.** When investors refer to the president's pro-growth agenda, they generally mean regulatory reform, infrastructure spending and tax reform. President Trump has already enacted regulatory changes through executive orders. And we think a major infrastructure package is a low probability at this point. That means tax reform (especially corporate tax reform) will probably be the biggest political economic driver.

3. **Failure of the GOP health care plan makes tax reform more difficult.** A major component of the American Health Care Act was a $1 trillion repeal of taxes that were enacted as part of the Affordable Care Act and a corresponding set of cuts to Medicaid. Without that baseline reduction, policymakers will be forced to find other revenue offsets, making tax reform more difficult.

4. **Investors are also focusing on another possible government shutdown.** Congress and the president have until April 28 to pass a 2018 fiscal year budget or a continuing resolution. We think the odds of a shutdown are very low, but unless or until tax reform is passed, the debt ceiling will become an increasing political problem in the second half of the year.

5. **The extent and pace of economic growth will be a major driver of equity returns.** If one believes the "reflation trade" is continuing and growth is accelerating, equities should fare well. If, however, that trade is ending and the economy is in neutral, equities will more likely be stuck in a trading range.



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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.

Economic Growth, Not Politics, Is Probably the Biggest Risk

For some time, we have argued that equities and other risk assets looked overextended following their strong run-up since the election. In recent weeks, equities have been trading sideways and government bond prices have recovered.

But we have not seen a significant setback in risk assets or a return to a true "risk off" environment. Nevertheless, we believe risk assets such as equities and high yield bonds remain vulnerable in the near term, meaning we could see a continued period of consolidation or a more pronounced downturn.

Investors seem to be most concerned about politics as a possible catalyst for a market setback. The debt ceiling issue is resurfacing and real progress is lacking on a 2018 budget agreement. Tax reform may also experience some roadblocks. President Trump has signaled he will be more involved in crafting tax legislation than he was with health care reform. We expect he and his allies in Congress will create legislation that can be passed. However, without the baseline reductions that were part of health care reform, any tax bill must be revenue neutral or expire in 10 years in order to avoid a Democratic filibuster. (Alternatively, Republicans and Democrats could come together on a bipartisan bill, but that seems like a remote possibility.) Ultimately, we expect a tax reform bill will be passed, but it will probably be more limited than many hope.

More than politics, the economy probably presents a more probable roadblock for equities. We think economic sentiment may be too high and elevated confidence may make investors vulnerable to downside economic surprises. To be sure, we are not expecting a significant economic slowdown, but the nearly non-stop pace of positive economic data is unlikely to continue. At some point, a setback will likely be triggered by a manufacturing decline, soft oil prices, weakening data from China or some other factor, which could spark a risk-off phase.

Nevertheless, we remain constructive in the medium- and long-term toward risk assets, but are growing increasingly cautious about the short-term outlook. ■

2017 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500 Index	0.8%	6.1%
Dow Jones Industrial Average	0.3%	5.2%
NASDAQ Composite	1.5%	10.1%
Russell 2000 Index	2.4%	2.5%
Euro Stoxx 50	0.8%	8.5%
FTSE 100 (U.K.)	0.2%	5.3%
DAX Index (Germany)	1.1%	8.8%
Nikkei 225 (Japan)	-1.6%	4.4%
Hang Seng (Hong Kong)	-1.0%	9.9%
Shanghai Stock Exchange Composite (China)	-1.4%	4.8%
MSCI EAFE (non-U.S. developed markets)	0.1%	7.4%
MSCI Emerging Markets	-1.1%	11.5%
Bloomberg Barclays U.S. Aggregate Bond (bonds)	0.1%	0.8%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	0.0%	0.1%

Source: Morningstar Direct and Bloomberg, as of 3/31/17. 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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1 Source: Morningstar Direct, as of 3/31/17 **2** Source: Conference Board

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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GPE-BDCOMM1-0417P 24107-INV-W-04/18