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Weekly Investment Commentary

27 August 2018

Investors look past risks to bid stocks to new highs

Last week featured multiple negative political headlines for President Donald Trump that questioned the stability of his administration. The news was also dominated by signs of increased trade tensions between the U.S. and China, as well as statements from Federal Reserve Chair Jerome Powell that interest rate hikes were likely to continue. Despite the noise, however, investors continued moving money into stocks, causing the current bull market to become the longest in history and the S&P 500 Index to reach new record highs by the end of last week.[1]

HIGHLIGHTS

- **Despite rising political risks, equity markets are experiencing the longest bull market on record while stock prices are at new highs.**
- **We don't want to discount potentially significant risks (including still-uncertain trade policy), but we also don't believe this economic expansion and equity bull market will end soon.**

Robert C. Doll, CFA
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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.

Weekly top themes

1. ***The Fed appears on course to continue with regular, slow interest rate increases.*** Fed Chair Powell's much-watched speech at Jackson Hole last week confirmed that rate increases are likely to continue and the Fed does not see any global risks that would change this approach.

2. ***Corporate profit margins have likely peaked for the cycle.*** Margins have risen to all-time highs in the first half of this year.[1] While we are not calling for a sharp drop in earnings or profits, a combination of mounting wage pressures and rising interest rates will likely drag on profit levels going forward.

3. ***Rising productivity growth should help sustain the current economic expansion.*** Improving productivity has been a missing ingredient in the economic expansion for years, but that trend is changing. Improving productivity should help support profit margins and keep core inflation from rising too high.

4. ***We are unlikely to see significant reductions in trade uncertainty until after the midterm elections.*** The United States appears to be getting closer on NAFTA agreements and a resolution with the European Union about tariffs on industrial goods. Should these issues get resolved, it would likely increase pressure on China to agree to U.S. trade demands. The results of the midterms will go a long way to determining how much political capital President Trump has to pursue his trade policies.

5. ***The circus in Washington may contribute to additional market volatility, but it is highly uncertain how much it matters.*** We don't want to make light of the mounting troubles the president faces, but we are more focused on metrics such as consumer and business confidence levels as signs of how much the political turmoil will negatively affect financial markets.

We see threats to equities, but we don't believe this bull market is over

It is natural to ask what risks will likely cause the bull market to end, as equity prices again reach new highs and the roller coaster action that has dominated markets since February appears to be over (at least for now). Rising protectionism appears to be the biggest theat. From a rational perspective, we think this risk should fade since trade restrictions are ultimately a lose-lose proposition. And the United States appears more willing to negotiate than President Trump's tough rhetoric would indicate. Trade uncertainty remains a wildcard, but we still believe that an all-out trade war is unlikely.

Rising bond yields are also an oft-cited risk for equities. This threat has been slow moving so far in this cycle. Over the past decade, yields have moved abruptly higher, followed by long periods of consolidation. The Fed and other central banks remain committed to slowly increasing interest rates and the global economy appears to be in an uneven acceleration mode. This should be a recipe for higher yields over time, but we think the pace of the advance should remain contained, meaning the equity bull market should be able to cope.

Since the equity bull market began in March 2009, it has been the most distrusted in memory. We have seen several significant corrections, including in 2010/2011, 2015/2016 and earlier this year. But the length and breadth of the advance has been impressive. We are now experiencing the longest bull market on record, and it hasn't been dominated by a single sector or market area.

The latest advance in prices appears due to solid fundamentals (strong earnings and solid economic growth) as well as the easing of some risks, such as fears of contagion from the Turkish lira collapse. Today, skeptics point to such factors as the flattening yield curve, high corporate leverage or the Fed's shrinking balance sheet as reasons to believe this economic expansion and bull market are drawing to a close. But we are more constructive and believe the longest running bull market in history still has legs.

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2018 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	YTD
S&P 500	0.9%	8.9%
Dow Jones Industrial Avg	0.5%	5.9%
NASDAQ Composite	1.7%	15.9%
Russell 2000 Index	2.0%	13.2%
Euro Stoxx 50	3.5%	-2.7%
FTSE 100 (UK)	1.3%	-3.3%
DAX (Germany)	3.4%	-7.2%
Nikkei 225 (Japan)	0.8%	1.5%
Hang Seng (Hong Kong)	1.8%	-5.5%
Shanghai Stock Exchange Composite (China)	3.1%	-19.5%
MSCI EAFE	1.6%	-2.2%
MSCI EM	2.7%	-7.5%
Barclays US Agg Bond Index	0.3%	-0.8%
BofA Merrill Lynch 3-mo T-bill	0.0%	1.1%

Source: Morningstar Direct, Bloomberg and FactSet as of 24 August 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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1 Source: Morningstar Direct, Bloomberg and FactSet

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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