NUVEEN ASSET MANAGEMENT

Bob Doll - 10 reflections on where we might be heading March 2020

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Weekly Investment Commentary

23 March 2020

10 reflections on where we might be heading

Panic selling continued last week, driving U.S. stocks down close to 15% for the week.[1] Prices dropped 12% on Monday for the third-worst day in history (after the 13% decline on Black Monday in 1929 and 20% on Black Monday in 1987).[1] In other markets, the dollar continued to show strength and oil prices plummeted 29% for the week, but did rally on Thursday.[1] The good news is that policy response has been quick and strong, and we still expect the eventual economic and market rebound to be sharp after a deep recession.

HIGHLIGHTS

- **The coronavirus infection rate is climbing sharply, the U.S. and world are in the start of a deep recession and financial markets are strained. Volatility and fear will remain for some time, yet we think stocks have a good chance of moving higher over the next 12 months and should outperform bonds.**

- **The factors we are watching to confirm a bottom is in place: an eventual decline in new cases, falling credit spreads, rising Treasury yields and oil prices and stable weekly jobless claims.**

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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.

10 themes to consider

1. The unknowns make it hard to forecast the trajectory of the economy and markets. Health care policymakers' forecasts vary widely, with some expecting new cases in the U.S. to peak in a few weeks and others saying it could be months. We also don't have a good sense of how quickly testing will come online or what treatments might be effective. On a positive note, China has three consecutive days without a new case.

2. We are starting a deep recession. The virus countermeasures have slowed economic activity to a crawl. We are just starting to see reflections in the economic data, such as the March Empire Manufacturing Index plummeting a record 34.4 points to -21.5.[2] Initial unemployment claims were up 70,000 last week and could approach one million this week.[3] Many companies, such as airlines, are severely cutting services and others, such as auto manufacturing, are shutting down.

3. Policy response has been the fastest and strongest outside of wartime measures. The Federal Reserve has been extremely aggressive, injecting $1.5 trillion of liquidity into the markets, cutting interest rates to zero and launching a range of facilities designed to keep credit and lending markets functioning. Washington is also finally taking the crisis seriously, passing a bill aimed at providing a safety net for workers and helping health care supply. The focus now is on a $1.5 to $2 trillion stimulus package comprising tax refunds, small business loans, industry-specific relief and money market guarantees. Financial markets themselves have also provided stimulus, as lower rates prompt mortgage refinancing and lower oil and gasoline prices should help consumers.

4. Financial market flows point to massive capitulation. Over the last two weeks, flows into money markets and out of credit investments such as high grade, high yield and emerging markets debt were the strongest on record.[1] Equities have also seen massive outflows.

5. Credit market liquidity is the main immediate risk. Individuals have been selling any liquid investment to raise cash, putting a tremendous strain on credit conditions. Credit market stability is likely to be the first signal that the immediate financial panic is over. Economic improvement will take far longer.

6. Election prospects are trending in the Democrats' favor. Per the PredictIt predictions market, Donald Trump had a 59% chance to win reelection one month ago. That has since fallen to 46%. Likewise, the chance of Republicans holding the Senate fell from 73% to 53% and the chance of the House staying Democratic has risen from 57% to 75%.

7. We think the impact on economic growth will be extremely sharp but hopefully short-lived. Economists' second quarter growth predictions are shifting wildly, currently somewhere between -10% to close to -25%. Our best guess at this point is first quarter growth down around -5% and second quarter growth down between -10% and -15%. If the crisis passes in a few months, third and fourth quarter growth could rebound to between 5% and 10%. We also think the current 3.5% unemployment rate could double, but also hopefully recover quickly.

8. The direction of equity prices will depend on how badly corporate earnings are damaged. In a normal recession, corporate earnings tend to fall somewhere between 15% and 20%. If 2020 earnings are down 20%, that would equate to $132 for the S&P 500.[1] And with valuations around 18 times earnings, that would put the value of the S&P at 2,350 (which is about where it is right now).[1]

The key will be the eventual upturn. If 2021 earnings rebound to $160 and valuations fall to 16 times earnings (which would be reasonable in a quick recovery), that would put the 2021 level of the S&P 500 at 2,550.[1] That would, in turn, represent a 10% gain from current prices. Of course, all of this is hypothetical, but it provides a framework for forecasting possible price levels.

9. We think stocks remain in a bottoming process. We had previously hoped that 2,350 (the level the S&P reached in December 2018) would be the low, but stocks broke through that level on Friday.[1] Nevertheless, technical factors still suggest stocks are bottoming. The number of new lows has been very high, put/call ratios are at extremes, volatility appears to have peaked and forced selling by leveraged hedge funds and risk-parity funds may be exhausted. However, bottoming is a process, not an event, meaning this could take some time.

10. Financial market internals suggest depressed areas could be poised for a sharp rebound during an eventual recovery. Given how sharply bond yields have fallen, the yield relationship between stocks and bonds is more advantageous for stocks than at any time during the last 65 years. At the same time, the valuation spread between value and growth is at extremes only topped by the Great Depression and the recent financial crisis. We're not calling a bottom, but these relative valuation spreads make us think that stocks should outperform bonds and value will beat growth over the next 12 months.

2020 PERFORMANCE YEAR TO DATE

	Returns	
	Weekly	**YTD**
S&P 500	-15.0%	-28.3%
Dow Jones Industrial Avg	-17.3%	-32.4%
NASDAQ Composite	-12.6%	-23.1%
Russell 2000 Index	-16.1%	-39.0%
MSCI EAFE	-5.8%	-31.2%
MSCI EM	-9.8%	-27.7%
Bloomberg Barclays US Agg Bond Index	-2.3%	0.0%
BofA Merrill Lynch 3-mo T-bill	0.1%	0.6%

Source: Morningstar Direct, Bloomberg and FactSet as of 20 Mar 2020. 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 indexes are unmanaged and unavailable for direct investment.

"When it happens, we think the recovery in the economy and in risk assets will be sharp and rapid."

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1 Source: Bloomberg, Morningstar and FactSet

2 Source: Federal Reserve

3 Source: Department of Labor

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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