Conditions Are Improving, but Investors Remain Skeptical

NUVEEN ASSET MANAGEMENT

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U.S. equities snapped their five-week winning streak and dropped slightly in a holiday-shortened trading week as the S&P 500 Index fell 0.7%.[1] The news was dominated by the terrorist attacks in Brussels, but outside of a short-lived move to safe-haven assets, the horrific events appear to have had limited market impact. Instead, investors appeared to have taken a step back in response to some more hawkish comments from Federal Reserve officials and a sense that the strong rally since mid-February may have been overdone.

Key Points

- U.S. economic data suggest an eventual improvement in corporate earnings results.
- Several risks that were causing investor consternation have faded.
- Nevertheless, while we have a positive long-term view, we remain cautious about the near-term prospects for equities.

The U.S. Economic Backdrop is Solidifying

While markets have rallied strongly over the past couple of months, it should come as no surprise that investor skepticism remains high given that we have seen numerous ups and downs in the market over the past several years. That said, however, it does appear to us that the economic backdrop is providing more indicators that the bullish argument may eventually bear fruit. The ISM Manufacturing Index has climbed for two months in a row, and we expect March's numbers may improve as well.[2] Additionally, both the Empire and Philadelphia Fed manufacturing surveys have been showing strength.[3] The recent rally in commodity prices and the decline in the value of the dollar are also positives for equities.

The U.S. economy may be finally benefitting from the numerous sources of stimulus that materialized last year. Lower interest rates, rising monetary supplies and the long-term fall in oil all come with positive long-term effects, which may now be providing support. The ongoing strength in the labor market, improving consumer spending and what appears to be a long-awaited turnaround in manufacturing suggests that the U.S. economy remains in a slow-but-steady state of improvement.

Downside Risks Remain, but Appear to Be Easing

There are, as always, risks investors must consider, but from a broad perspective, risk factors seem less pressing than they did several months ago. The Fed's recent indication that it will slow its pace of rate increases provides more certainty for financial markets. Inflation appears to be rising, but remains below the Fed's 2% target level, which gives the central bank added flexibility.[4] At some point, rising prices and wages will constrain the Fed, but for now it can continue to move slowly. On a related point, the softer dollar has removed some risk from the economy and financial markets as this has helped to stabilize commodity prices and emerging market currencies. The weaker dollar should also provide some sorely-needed support for corporate earnings.

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Geopolitical flare-ups and terrorism have unfortunately become a fact of life and continue to have the potential to disrupt economic growth and financial markets. But while the human costs of such events can be heartbreaking, their effects on investors have tended to be contained.

Improvements May Be Necessary for a Sustained Advance

Despite all of these long-term positives, the current equity rally seems tentative, and we remain cautious about the near-term market outlook. For one, we think much of the recent rally can be attributed to the rebound in oil prices. It appears to us that the oil price advance came about largely as a result of expectations of falling supplies, which have not yet materialized. By their nature, oil prices are volatile and it seems inevitable that we will see another correction at some point. If and when that happens, that could cause another sell-off in risk assets.

Additionally, corporate earnings may continue to struggle for some time. Current consensus forecasts point to flat earnings-per-share growth this year versus 2015.[5] And it is tough to make an argument for stronger equity markets without first seeing improvements in earnings.

So given all of these crosscurrents, where does that leave investors? Over time, we think improving economic growth, still-low interest rates, low inflation and a more stable dollar should be positives for corporate earnings and ultimately for equity prices. This process may take several months to materialize, however. For now, we think investors should continue to watch for signposts such as improvements in manufacturing data and global trade, signs of oil prices stabilizing into a trading range and ongoing strength in the labor market as indicators for a longer-term equity uptrend. ■

2016 Performance Year to Date

Returns

	Weekly	YTD
S&P 500 Index	-0.7%	0.1%
Dow Jones Industrial Average	-0.5%	1.2%
NASDAQ Composite	-0.5%	-4.4%
FTSE 100 (U.K.)	-3.4%	-4.7%
DAX Index (Germany)	-1.8%	-6.0%
Nikkei 225 (Japan)	0.3%	-4.7%
Hang Seng (Hong Kong)	-1.6%	-6.8%
Shanghai Stock Exchange Composite (China)	0.1%	-16.2%
MSCI EAFE (non-U.S. developed markets)	-2.2%	-4.8%
MSCI Emerging Markets	-1.7%	2.6%
Barclays U.S. Aggregate Bond (bonds)	0.0%	2.4%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	0.0%	0.1%

Source: Morningstar Direct and Bloomberg, as of 3/24/16. 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.

"It may take time, but we should eventually see a sustained advance in equities."

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1 Source: Morningstar Direct, as of 3/24/16 **2** Source: Institute for Supply Management **3** Source: Federal Reserve **4** Source: Bureau of Labor Statistics **5** Source: Bloomberg

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. **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. **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.

RISKS AND OTHER IMPORTANT CONSIDERATIONS

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