nuveen
A TIAA Company

TEN PREDICTIONS FOR 2018: 3Q UPDATE

The cycle is old, but stocks look strong

WHAT'S INSIDE

Robert C. Doll, CFA
Senior Portfolio Manager and Chief Equity Strategist

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.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

U.S. economy moves ahead of global growth

THE U.S. ECONOMY APPEARS TO BE SURGING AHEAD. The latest reading shows U.S. real gross domestic product growth accelerated to 4.2% in the second quarter (the strongest pace since 2014).[1] At the same time, nominal growth jumped to 5.4%.[1] We're seeing strength in consumer spending, manufacturing and business investment, while at the same time the labor market continues to push strongly forward. We expect growth to continue and wouldn't be surprised to see real growth remain above 3% for the rest of the year.

IN CONTRAST, SOME OTHER AREAS OF THE WORLD HAVE BEEN STRUGGLING A BIT. Europe continues to suffer from structural problems, and it doesn't help that European Central Bank policy looks uncertain. Chinese growth is also slowing, although it appears more likely than not that the country will experience a soft landing. Overall, we think the global economy remains in decent shape, but the differences between the U.S. and rest of the world have been striking.

THIS GLOBAL DISPERSION CAN LARGELY BE EXPLAINED BY THE U.S. DOLLAR. The value of the dollar has moved sharply higher this year, thanks to stronger relative growth and higher interest rates. Recent tax cuts and an easier regulatory environment have also made dollar-denominated investments more attractive. A rising dollar has the potential to eventually cause problems, as it can act as a drag on earnings and cause further issues for emerging markets. We think a pause and eventual retreat in the dollar is the most likely forecast.

TRADE REMAINS A SIGNIFICANT WILDCARD, BUT WE ARE OPTIMISTIC THAT TENSIONS WILL EASE IN THE COMING MONTHS. Talks on the NAFTA renegotiation seem to be moving in a positive direction. And despite periodic setbacks and the announcement of new tariffs, we remain convinced that the United States and China will be able to come to some agreement that will reduce uncertainty for consumers and businesses. These issues are unlikely to go away any time soon, however, and remain a potential downside risk.

THE OTHER POLITICAL WILDCARD IS THE U.S. MIDTERMS. We think the most likely scenario is that the Democrats take the House of Representatives while the Republicans keep the Senate. In general, we think the closer we remain to the status quo, the better it probably is for U.S. stocks as a whole. But even if Democrats manage to sweep Congress, they wouldn't have a veto-proof majority to rescind tax reform. In any case, the good news could be that history suggests that stocks may be poised for an increase regardless: The S&P 500 Index has not fallen in the 12 months following a midterm since 1946.[2]

KEY INDEX PERFORMANCE TOTAL RETURNS	3Q18	YTD
S&P 500 Index	7.7%	10.6%
Dow Jones Industrial Average	9.6%	8.8%
NASDAQ Composite	7.4%	17.5%
Russell 2000 Index	3.6%	11.5%
Euro Stoxx 50	-0.1%	-3.4%
FTSE 100 (UK)	-1.8%	-2.7%
DAX (Germany)	-1.0%	-8.4%
Nikkei 225 (Japan)	6.2%	6.8%
Hang Seng Index (Hong Kong)	-2.2%	-4.3%
Shanghai Stock Exchange Composite (China)	-3.3%	-17.2%
MSCI World Index (ex U.S.)	5.1%	5.9%
MSCI Emerging Markets Index	-1.0%	-7.4%
Bloomberg Barclays U.S. Aggregate Bond Index	0.0%	-1.6%
BofA Merrill Lynch 3-Month Treasury Bill (Cash)	0.5%	1.3%

Source: Morningstar Direct, Bloomberg and FactSet as of 30 Sep 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 indexes are unmanaged and unavailable for direct investment.

Stock prices resume their upswing

STOCKS CLOSED THE QUARTER WITH PRICES BUMPING UP AGAINST RECORD HIGHS AGAIN FOR THE FIRST TIME SINCE JANUARY.[3] And while prices are the same as they were nine months ago, conditions look quite different, and the backdrop looks firmer today. For one, earnings are much stronger now than they were then. And that means valuations are less rich. That backdrop, combined with stronger economic growth, creates a friendly environment for equity markets.

FOR THE QUARTER, U.S. STOCKS CONTINUED THEIR WINNING WAYS. The S&P 500 Index rose 7.7%, which was its largest quarterly gain in nearly five years.[3] The primary tailwind for stocks this past quarter was a continuation of exceptionally strong corporate earnings, as well as a sense of improving sentiment about the direction of the economy.

EVERY SECTOR OF THE MARKET POSTED POSITIVE RETURNS DURING THE THIRD QUARTER.[3] In general, cyclical sectors outperformed defensive areas of the market, although health care bucked the trend by leading the way.[3] From a style perspective, growth stocks outperformed, with the Russell 1000 Growth Index rising 9.2% compared to 5.7% for the Russell 1000 Value Index.[3]

OUTSIDE THE UNITED STATES, EQUITY RESULTS WERE LESS ROSY. A combination of growth worries, the rising value of the U.S. dollar, and trade tensions conspired to hold most global markets back. Japanese stocks were able to post positive results, but European and other Asian markets lost ground. Chinese stocks continued to fall during the quarter, and emerging markets came under increased pressure.

INTEREST RATES HAVE STARTED RISING, CREATING POSSIBLE RISKS FOR STOCKS. Outside of the jump in equity prices, the other big story of the quarter was the resumption in the increase in bond yields. The yield on the 10-year Treasury moved back over 3% by the end of the quarter, ending at 3.06%.[3] In this environment, the Bloomberg Barclays U.S. Aggregate Bond Index was flat for the quarter and is now down 1.6% for the year.[3] Looking ahead, rising interest rates may become increasingly problematic. We have already seen signs of higher business and household borrowing costs. Should rates continue to move higher, consumption and investment growth could slow next year, which could create headwinds for the economy and for the stock market.

EQUITY SECTORS TOTAL RETURNS	3Q18	YTD
Communication Services	1.1%	7.4%
Consumer Discretionary	9.3%	21.9%
Consumer Staples	5.7%	-3.7%
Energy	0.6%	7.5%
Financials	4.4%	0.1%
Health Care	14.5%	16.6%
Industrials	10.0%	4.8%
Information Technology	12.4%	25.0%
Materials	0.4%	-2.7%
REITs	0.9%	1.7%
Utilities	2.4%	2.7%

Source: Morningstar Direct, Bloomberg and FactSet as of 30 Sep 2018. Equity Sectors are classified using the Global Industry Classification Standards (GICS) based on the S&P 500. 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.

TEN PREDICTIONS FOR 2018

SCORECARD *Overall Scoring*	
✓	HEADING IN THE RIGHT DIRECTION
?	TOO EARLY TO CALL
✗	HEADING IN THE WRONG DIRECTION

From nearly perfect to less perfect

At the start of the year, we expected 2018 to be "less perfect" than 2017, as we saw continued decent economic growth and corporate earnings, as well as low but rising inflation and yields. The year has actually been a bit better than we expected, and at this point, most of our predictions are proving to be correct.

1 ✓

U.S. real GDP reaches 3%, and nominal GDP 5% for the first time in over a decade.

We were out of consensus on the positive side when we made this prediction, but it may wind up being too conservative. After a relatively slow first quarter, real growth has picked up strongly and should be comfortably ahead of our prediction level by the end of the year. With inflation climbing modestly, we also believe nominal growth should climb.

2 ✓

Despite ongoing protectionism, the global expansion continues with the fewest countries in recession in history.

Rising trade protectionism remains a serious threat to the global economy, and won't be going away any time soon. So far, however, the world economy has looked past these issues. While growth in some parts of the world may be slowing, the overall world economy remains in good shape.

3 ✓

Unemployment falls to the lowest level in nearly 50 years as wage growth is the highest since the Great Recession.

Both halves of this prediction have already come to pass. The unemployment rate fell to 3.9%, matching its lowest rate in 50 years.[4] Wage growth has slowly risen from 2.5% to 2.9%, representing a new high for this economic cycle.[4] We wouldn't be surprised to see wage growth top 3% by the end of the year.

4 ✓

The yield curve flattens (but does not invert) as the 10-year Treasury yield reaches 3% for the first time since 2014.

Bond yields fell for most of the summer, but again moved higher toward the end of the quarter. The yield curve has moved around a bit, but is markedly flatter than it was at the start of the year, with the spread between the 2-year and 10-year Treasury yield narrowing from 52 basis points to 29 by the end of the third quarter.[3] We expect both modest flattening of the yield curve and unevenly rising yields to continue.

5 ✓

Stocks enjoy longest bull market in history but experience a 5+% correction after the longest period without one.

This is another prediction that has come to pass. As of August 22, 2018, this current bull market has become the longest in history.[5] And the second half of this prediction happened in February when stocks experienced their first significant correction since 2016.[3]

> *We prefer companies with domestically sourced earnings and those with the ability to utilize high levels of free cash flow for business reinvestment.”*

6 ✓	**U.S. equity returns lag earnings growth for the first time in six years, the longest streak in decades.**	This prediction is our “most correct” of the year, since earnings growth has been amazingly strong while stock prices have advanced relatively modestly. At present, year-over-year earnings per share growth for the S&P 500 stands at an incredible 25.7%.[6] The S&P 500 Index itself, in contrast, has returned “only” 10.6%.[3]
7 ✓	**Equities beat bonds for the seventh consecutive year for the first time in nearly a century.**	This prediction was looking dicey earlier in the year following the equity market correction, but as we enter the fourth quarter, it looks likely we will get this one right. As of the end of the third quarter, the S&P 500 Index was up 10.6%, while the Bloomberg Barclays U.S. Aggregate Bond Index was down 1.6%.[3]
8 ?	**Corporate capital expenditures increase at the expense of share buybacks.**	This is one prediction that is a bit muddled. Capital expenditure levels are picking up and have advanced 7% over the past year.[3] This increase is boosting productivity and should help continue the economic expansion. Buybacks are up as well so far this year, but only by 2%.[3]
9 ✓	**Telecommunication services, information technology and health care outperform utilities, energy and materials.**	This prediction is trending in the right direction so far. A basket of our most-favored sectors is up 16.3%, while a basket of our least-favored is up 2.5%.[3] Assuming economic growth continues to improve, we think this prediction will remain in the correct column.
10 ?	**Republicans lose the House, retain the Senate and further distance themselves from President Trump.**	If there is anything we have learned about this political environment, it’s that trying to forecast what might happen next is close to impossible. Nevertheless, we think our predicted outcome is the most likely. Democrats appear to have picked up momentum in recent polling, and the intense drama over the Kavanaugh hearings may further complicate prospects for the GOP.

Equities appear solid, but cracks loom on the horizon

THE OUTLOOK FOR STOCKS STARTS WITH CORPORATE EARNINGS, WHICH HAVE BEEN AMAZINGLY STRONG. Earnings were up over 25% in the first half of the year, an astonishing result for the ninth year of an economic expansion.[3] We would attribute these results evenly between the effects of the tax cuts, strong revenue growth and margin improvements.

WE THINK EARNINGS SHOULD REMAIN STRONG, BUT MAY HAVE PEAKED. As interest rates and wage pressures rise, we think earnings growth is bound to slow. The benefits of the 2018 tax cuts will fade over time, while borrowing and labor costs are rising. But it is important to remember that just because earnings growth may have peaked, that doesn't mean earnings are falling. We expect growth to dip to a still-high 20% range or so for the second half of 2018. We do, however, think 2019 expectations may be too high and think growth will slip back into the single digits next year.

SOLID ECONOMIC GROWTH AND STRONG EARNINGS SHOULD BE GOOD FOR STOCKS, BUT WE DO SEE SOME RISKS. Chiefly, we think the risks of the economy overheating are greater than the risk of recession at this point. Specifically, we think rising inflation and higher interest rates need to be watched carefully. This economic cycle won't last forever, and our best guess about what might end it is a rise in inflation that forces the Federal Reserve to more aggressively raise interest rates. We are also concerned about trade risks and a host of geopolitical issues, including relations with Iran and North Korea.

SO HOW LONG CAN THE BULL MARKET CONTINUE? We would answer that question by asking another: How long will the economy expand? In our experience, the lead time between a yield curve inversion and the peak in stock prices is about nine months. And it usually takes about nine months after a peak in stock prices before the onset of a recession. The yield curve is flattening (but hasn't inverted yet), although if current trends continue, that may mean a yield curve inversion in the middle of 2019. And that would translate into a recession occurring sometime in late 2020 or early 2021. Of course, we could see events like mounting credit issues, faster-moving inflation or an escalation in trade issues that could push this time forward.

SO WE THINK THIS BULL MARKET HAS LEGS. Sir John Templeton famously said, "Bull markets are born in pessimism, grow on skepticism, mature on optimism and die on euphoria." At this point, it feels to us like this market is still in the optimism phase, meaning investors would still need to grow euphoric before we see its end. As such, we remain in the constructive camp.

> ***"With earnings still rising, we see no signs that this bull market is ending soon."***

Key themes for investors

MATCHING GOALS TO INVESTMENTS

As investors review their portfolios with their financial advisors, we offer the following themes as a guide:

Maintain an overweight in equities, but watch for risks: Over the long term, we believe that while this bull market is aging, age alone does not predict the end of a bull market. Solid economic growth and decent corporate earnings should help equity prices continue to rise.

Focus on selectivity: Gains will likely be narrower and more focused on specific companies and investment styles, so selectivity will be crucial. We continue to focus on companies that generate free cash flow and raise dividends. We are also focusing on companies with more domestic sources of earnings, those that would be beneficiaries of rising interest rates and more cyclical areas of the market.

Selection also matters in fixed income: With yields still low and the prospect of modestly rising rates, fixed income investing has become more challenging. Investors may want to rely on active managers with the flexibility to respond to market changes and the investment acumen to remain ahead of their peers in uncertain markets. We think focusing on credit sectors (including high yield) over government-related sectors makes sense, and we also see value in municipal bonds.

Alternatives can play multiple portfolio roles: Alternative assets, including real assets, real estate and other investments, may provide diversified sources of risk, return and/or income. Alternative strategies such as long/short or a market-neutral approach may have a low historical correlation to long-only, benchmark-oriented investments.

Characteristics we look for when evaluating companies:

- ***Free cash flow*** *can provide flexibility to raise dividends, buy back shares and reinvest in the business.*
- *Companies with the* ***ability to generate unit growth*** *may have an advantage over those that lack pricing power.*
- ***Economic sensitivity and above-average secular growth*** *may help insulate against market fluctuations.*

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

1 Bureau of Economic Analysis **2** Strategas Research **3** FactSet, Bloomberg and Morningstar Direct **4** Bureau of Labor Statistics **5** Bank of America Merrill Lynch Research **6** Credit Suisse

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy or sell securities, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her advisors.

Index definitions

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 of 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 a 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. The **MSCI World Index ex-U.S.** is a free-float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets minus the United States. 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. The **Russell 1000® Value Index** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The **Russell 1000® Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Risks and other important considerations

The views and opinions expressed are for informational and educational purposes only as of the date of writing and may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The information provided does not take into account the specific objectives, financial situation, or particular needs of any specific person. All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investments are subject to market risk or the risk that stocks will decline in response to such factors as adverse company news or industry developments or a general economic decline. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, tax risk, political and economic risk, and income risk. As interest rates rise, bond prices fall. Non-investment-grade bonds involve heightened credit risk, liquidity risk, and potential for default. Foreign investing involves additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. An alternative strategy sells securities that it has borrowed but does not own ("short sales"), which is a speculative technique. A strategy will suffer a loss when the price of a security that it holds long decreases or the price of a security that it has sold short increases. Losses on short sales arise from increases in the value of the security sold short, and therefore are theoretically unlimited. Because a strategy invests in both long and short equity positions, the strategy has overall exposure to changes in value of equity securities that is far greater than its net asset value. This may magnify gains and losses and increase the volatility of returns. In addition, the use of short sales will increase expenses. Past performance is no guarantee of future results.

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute.

Nuveen Asset Management, LLC is a registered investment adviser and an affiliate of Nuveen, LLC.

nuveen
A TIAA Company

Nuveen | 730 Third Avenue | New York, NY 10017 | 212.490.9000 | nuveen.com

GPE-BD10L-0918D 619815-INV-Q-10/19 3580_0918