Conflicting Crosscurrents

NUVEEN ASSET MANAGEMENT

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U.S. equities finished 0.83% higher last week,[1] with a rally on Friday driven by the May employment report that was in line with expectations. The week was dominated by a continued flurry of headlines: possible Fed tapering, global monetary policy credibility, quality of the U.S. economic recovery, sensitivity to rising rates for housing and stock prices and overall investor sentiment.

Waiting to Confirm Self-Reinforcing Economic Growth

We believe there is widespread but misguided concern that a shift away from current extreme monetary policies would signal the end of the U.S. equity bull market. In our view, the concern is misguided because it ignores the main reason the Federal Reserve has been priming the pump – the economic environment has been fragile with lingering high debt levels, risk averse business behavior, constrained fiscal policy and below target inflation. A return to a healthier economic climate that allows a normalization of monetary policy should provide signs of a bull market for risk assets, rather than a bear market. A monetary exit, whenever it comes, will likely be messy. Stocks and bonds could suffer as investors realize the hyper-accommodative monetary environment is coming to an end. But, in our opinion, any setback for stocks would be temporary, given that overall expectations about the economy and earnings would be improving.

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Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through ongoing market commentary and equity portfolio management.

Weekly Top Themes

1. **Nonfarm payroll rose 175,000 in May, slightly ahead of the consensus**[2]: The service sectors were the key growth driver, and manufacturing was weak. The unemployment rate moved up to 7.6%, while average hourly earnings were flat, which was a disappointment.

2. **The manufacturing Purchasing Managers' Index (PMI™) fell to 49.0% in May**[3]: Since the prior report data was 50.7%, this was much weaker than expected. The cold weather during the spring and fiscal restraint from sequester is weighing down the economy. We continue to expect the manufacturing economy to gradually improve in the second half of the year as fiscal and foreign issues moderate.

3. **Approximately 80% of the S&P 500 companies that provided outlooks for the second quarter issued negative guidance**[4]: Expectations for growth in earnings remain 1.3% for the second quarter.

The Big Picture

A full employment and economic recovery seems years into the future based on current high levels of unemployment, projected high long-term unemployment and under-employment. Since core inflation is now at the lowest level on record, we are puzzled by the mention of tapering by the Fed. The Fed has yet to achieve either side of its dual mandate: 1) inflation is below target, and 2) unemployment is still too high to warrant taking economic risk. Therefore, a period of catch-up growth is needed.

The consumer economy has seen a rebound as unemployment has fallen, balance sheets have repaired and home values have bottomed. On the corporate side, businesses remain hesitant to put cash to work and continue to act cautiously. Fed Chairman Ben Bernanke has made it clear that the central bank will only move after the economy performs well for an extended period, which would correspond with improving sentiment toward corporate profits. There is skepticism and distrust of the cyclical advance in stock prices, cash levels remain high and retail investors have just begun to relocate funds into equities. Compared with a few months ago, investors are definitely feeling better but not euphoric. We believe investors should prepare for more choppiness this summer as the market sifts through what is likely to be mixed fundamental and economic data. ■

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	0.83%	16.33%
MSCI World Ex U.S.	-1.09%	6.19%
MSCI Emerging Markets	-2.65%	-5.85%

Source: Morningstar Direct and Bloomberg, as of 6/7/13. 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.

"The market is trying to make sense of headlines… Fed tapering, global monetary policy credibility, quality of the U.S. economic recovery, sensitivity to rising rates for housing and stock prices and overall investor sentiment."

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1 Source: Morningstar Direct, as of 6/7/13. **2** Source: Bureau of Labor Statistics, "The Employment Situation – May 2013," June 7, 2013, http://www.bls.gov/news.release/empsit.nr0.htm **3** Source: ISM, "May 2013 Manufacturing ISM Report On Business®," June 3,2013, http://www.ism.ws/ismreport/mfgrob.cfm **4** Source: FactSet, "Earnings Insight," June 7, 2013.

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. **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.

RISKS AND OTHER IMPORTANT CONSIDERATIONS