Cyprus Reminds Us of Threats and Improving Global Economy

NUVEEN ASSET MANAGEMENT

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Equity averages sagged slightly last week. Strength later in the week made up for earlier weakness as the equity rally paused for the Cyprus crisis. We (and the consensus) perceive Cyprus as mainly a local problem and believe it supports our view to remain cautious with Eurozone weightings.

Bull Market will Continue, But Correction is Overdue

Last week's flash PMI reports reminded us of the Eurozone's economic challenges, which could worsen due to the uncertain Italian elections and the Cyprus crisis.

Global equity markets stumbled briefly on this questionable policy, making one wonder what it means to penalize savers by confiscating assets. The most recent misstep won't likely derail the bull market, but a short-term correction is overdue given the powerful gains since last June. However, the global economy is slowly strengthening, and policy makers remain extremely accommodative. This has kept a bid under equity prices. We've seen many favorable signs in the economy recently — in business and consumer spending, the housing market and labor markets. However, economic growth faces headwinds from tax increases and federal spending cuts. And portions of the global economy remain mired in recession or stagnation, reducing our export possibilities. Growth is likely to remain merely acceptable, and the unemployment rate should only slowly edge downward. This is not all bad for equities — it will keep inflation low and central bankers on our side.

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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. **Cyprus' rejection of the bailout proposal returned EMU event risk to the market,** pushing risk assets down and bond assets up. Since then, we and most investors have concluded that the numbers are small relative to the risks to both sides to allow for a compromise.

2. **The FOMC statement came close to expectations.** It reflected the somewhat better economic data, but the overall tone remained cautious and concerned about downside risk.

3. **It is too early to handicap a debt ceiling deal this summer.** Differences between the House and Senate bills are obviously impossible to bridge. But we believe more savings are coming and we reiterate that the market seems to want a combination of tight fiscal policy and loose monetary policy.

Positioning Remains a Mild Pro-Cyclical Tilt

The economic growth outlook will continue to be the key driver of equity market performance in the year ahead. We expect global growth to slowly solidify as the year progresses and well-known threats begin to recede. This warrants a mild pro-cyclical tilt in positioning. That said, we expect a gradual global transition from the slowdown last year to belief in a sustainable (albeit only moderate) economic expansion. Equity markets will also be periodically buffeted by lingering vulnerabilities, with the Cyprus crisis the most recent example.

The U.S. accounts for one-third of global market capitalization,[1] thus regional equity strategy largely boils down to a call on the U.S. The U.S. has been defensive many times in the past. Compared with its major counterparts, it has a more stable earnings profile, greater diversification and liquidity, perceived superior corporate governance and a strong equity culture. Yet some believe the U.S. can enjoy a prolonged period of outperformance as the economic recovery gains traction and drivers pay off, including shale oil/gas, a revival of manufacturing, ongoing technology leadership and perceived superior economic innovation.

Over time, with bumps along the way, we believe that modest P/E expansion is possible based on resilient earnings per share growth of mid-single digits in 2013. This is despite fiscal drags, double digit percentage dividend growth, and buybacks and acquisitions with surplus free cash flow.

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	-0.24%	9.69%
MSCI World (ex-U.S.)	-1.42%	5.24%
MSCI Emerging Markets	-2.51%	-3.44%

Source: Morningstar Direct, as of 3/22/13. 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.

"We doubt the Euro misstep is contagious, but believe a correction is overdue in the context of still higher prices by year-end."

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1 Source: The World Bank, 12/11.

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.

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