Equities Hit Pause

Weekly Investment Commentary June 3, 2013 | Volume 1.22

Stocks and other risk assets struggled last week, with the S&P 500 declining 1.11%.[1] Equities finished lower on Friday, the final trading session of May. The decline trimmed May's gains and sealed the second consecutive weekly decline for U.S. equities. The S&P increased 2.34% for the month and has gained 4.31% this quarter and 15.37% for the year.[1]

Yield Increases Leave Investors Wondering

Four weeks ago, the 10-year Treasury yield was 1.64%[2] with a backdrop of disappointing economic data and news of the Fed extending quantitative easing (QE). Since then, April's payroll report and other economic data improved, and the Fed floated a trial balloon about tapering off QE this summer. Now 10-year U.S. Treasury yields are 2.16%, up 50 basis points.[2] This spike has disturbed equity investors. In our opinion, the disturbance has been caused by the relatively rapid rise in rates, but the current rate level is not problematic. Rising bond yields should reduce momentum from dividend yield securities, and utilities weakened in May.

The FOMC leaders renewed their call for an early exit from QE at the start of the year but have not presented new arguments yet. More importantly, inflation is falling, rather than rising. Also, Ben Bernanke stated the Fed might begin to decrease purchases, provided there is continued improvement and confidence it will be sustained. He also warned about a premature tightening of policy.

Weekly Top Themes

1. **Consumer confidence reached a five-year high:**[3] The May Consumer Confidence Index® survey reported 76.2, ahead of April's 69.0. Consumers are more receptive to favorable economic news with respect to job gains and the overall economy.

2. **The improvement in the U.S. fiscal picture is stunning:**[4] Assuming current laws governing taxes and spending do not change, the Congressional Budget Office projects the budget deficit will shrink to $640 billion this year, or 4% of GDP. This amount is $200 billion less than expected. Modest fiscal austerity and moderate economic growth support the improvement.

3. **Cyclical sectors (e.g., information technology, industrials, energy) outperformed defensive sectors (e.g., utilities, telecommunications, consumer staples) in May:**[5] We believe this is based on lower inflation, which tends to lift the U.S. economy because it acts similarly to a tax cut.

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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.

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The Big Picture

We believe the equity bull market is intact, but complacency may have crept in. The market rarely accommodates the obvious, and we recognize that calling a correction has been a fool's game so far this year. It seems to us that, at a minimum, a pause in upward momentum is likely. We would argue for the following potential outcomes over the next several weeks:

What Could Happen?

1. 7-10% correction of the S&P 500 to approximately 1550
2. Consolidation in the 1600s
3. Continued strong market with new record highs before July 4

(We believe 1 and 2 are more likely than 3)

Key Reasons for Pullback

- Investor complacency
- Uncertainty regarding Fed policy (e.g. 10-year Treasury rates)
- Continued concern about economic growth in China
- Declining Japanese markets
- Overbought technical conditions

Although stocks are overbought and vulnerable to correction, we remain positive on equities over a 6- to 12-month horizon, given our moderately constructive growth outlook. Stronger earnings and gradual rotation out of bonds by some investors underlie our positive return expectations, as well as hyper-accommodative monetary policies, investor risk appetite and reasonable valuations. We would be patient but use weakness to add to equity positions. We prefer inexpensive cyclical companies with strong balance sheets, the ability to grow dividends and earnings stability over the last cycle. We remain underweight expensive, low beta, high dividend-yielding sectors like utilities and telecommunications.

2013 Performance Year to Date

	Returns Weekly	Returns YTD
S&P 500	-1.11%	15.37%
MSCI World Ex U.S.	-1.58%	7.36%
MSCI Emerging Markets	-1.62%	-3.29%

Source: Morningstar Direct and Bloomberg, as of 5/31/13. 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.

"A pause in upward momentum appears likely."

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Beta is a measure of the volatility of a portfolio relative to the overall market. A beta less than 1.0 indicates lower risk than the market; a beta greater than 1.0 indicates higher risk than the market.

1 Source: Morningstar Direct, as of 5/31/13. **2** Source: Bloomberg, as of 5/1/13 and 5/31/13. **3** Source: The Conference Board, "Consumer Confidence Index Improves in May," May 28, 2013, http://www.conference-board.org/data/consumerconfidence.cfm **4** Source: Congressional Budget Office, "Updated Budget Projections: Fiscal Years 2013 to 2023," May 14, 2013, http://www.cbo.gov/publication/44172 **5** Source: FactSet, as of 5/31/13.

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

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GPE-BDCOMM5-0513P