Conflicting Crosscurrents Move Equities Sideways

NUVEEN ASSET MANAGEMENT

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U.S. equities finished last week narrowly mixed, with the S&P 500 falling -0.02%.[1] While the second quarter earnings per share growth continues to move higher, revenue growth remains below trend. The economic calendar is focused on this week's release of the July employment report. Global macro headlines generated more uncertainty than direction for the markets.

Waiting for Stronger Earnings and Revenue Growth

Earnings and revenue metrics improved last week, although this dynamic had little impact on the broader market, as the results were not enough to drive a significant shift in sentiment. Approximately 50% of the S&P 500 companies have reported second quarter earnings, and more than 70% have beaten consensus earnings per share expectations by roughly 3% in aggregate.[2] Companies in the industrial sector noted Europe has bottomed out and shows some signs of improvement.

Weekly Top Themes

1. **The debate over succession of Fed Chairman Bernanke is heating up.** The market seems comfortable with the widespread perception that Fed Vice Chairman Janet Yellen could get the nod. New reports suggest the Obama administration would prefer former White House Economic Advisor and Treasury Secretary Larry Summers. The news is an overhang since Summers work style could compete with the consensus thinking Ben Bernanke has fostered.

2. **Earnings per share (EPS) is coming in slightly better than expected, based on further net margin expansion.**[2] Sales growth has been tepid, and management commentary suggests that this will likely continue. Headwinds include emerging markets, negative effect from currency translation as a result of the strong U.S. dollar, mixed news from Europe and a limited increase in U.S. capital expenditures (CAPEX). As a result, EPS guidance is being trimmed for the second half.

3. **The Detroit bankruptcy filing was the largest municipal bankruptcy in U.S. history.** Although the problems in Detroit were well known, the timing of the announcement came as a surprise. Hopefully other struggling cities will observe the warning signals about the importance of innovation and rehabilitation.

Robert C. Doll, CFA

Chief Equity Strategist,
Senior Portfolio Manager

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.

4. **The risk of a major budget confrontation is rising.** President Obama recently warned Republicans about the pending budget battle this fall. Meanwhile, Senate Republicans stated they won't support any legislation funding the government unless it decreases funding to the Affordable Care Act. No compromise is currently in sight.

5. **Signs of higher spending are emerging, with leading indicators of investment turning higher.** After the 50-year low in U.S. fixed investment relative to GDP during the financial crisis, CAPEX levels have increased. However, the deficit continues and spending is still below trend. As CEO confidence improves and political uncertainty falls, we believe this creates a recipe for increased investment.

The Big Picture

We expect choppiness in the equity market over the short term for several reasons:

- Uncertainty over Fed leadership
- Recent 5% drop in the Japanese stock market[3]
- Mixed earnings and lackluster revenues
- Renewed concerns over the debt ceiling
- Current noise in the home building sector

Beyond the short term, we think offsetting crosscurrents have obscured signs the economy is improving. But positive factors such as improvement in housing and employment will outlast the negative fiscal headwinds over the next 12 months. Financial markets appear to have adjusted to the notion of reduced Fed purchases, and an end to balance sheet expansion will refocus investor attention back to the profit backdrop. Therefore, we are watching corporate earnings and revenues carefully.

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	-0.02%	20.01%
Euro STOXX 50	2.03%	8.20%
FTSE 100 (UK)	-0.40%	7.79%
DAX (Germany)	0.02%	8.78%
FTSE MIB (Italy)	2.94%	3.96%
Nikkei 225 (Japan)	-1.04%	20.43%
Hang Seng (Hong Kong)	2.86%	-0.59%
Shanghai Stock Exchange Composite (China)	1.18%	-7.45%
MSCI World Ex U.S.	0.32%	9.81%
MSCI Emerging Markets	1.22%	-7.07%

Source: Morningstar Direct and Bloomberg, as of 7/26/13. 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 continue to believe that the next noticeable increase in equities will require acceleration in earnings and top-line revenue growth."

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1 Source: Morningstar Direct, as of 7/26/13. **2** Source: FactSet Earnings Insight, 7/26/13, http://www.factset.com/earningsinsight. **3** Source: Bloomberg, as of 7/26/13.

The **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. **Euro STOXX 50 Index** is Europe's leading Blue-chip index for the Eurozone and covers 50 stocks from 12 Eurozone countries. **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. **FTSE MIB Index** is an index of the 40 most liquid and capitalized stocks listed on the Borsa Italiana. **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. **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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