(Yawn)...As Equities Advance Another 2%

NUVEEN ASSET MANAGEMENT

WEEKLY INVESTMENT COMMENTARY MAY 20, 2013 | VOLUME 1.20

U.S. equities advanced again last week, with the S&P 500 increasing 2.1%.[1] Global stocks are reaching new highs in this cycle and the U.S. market is at an all-time high. Bonds were hurt in the move, dragging credit down, while commodities fell slightly on weaker manufacturing data. The unrelenting equity rally and an environment without positive news about earnings and the economy is making many investors uncomfortable.

Investors Are Still Awake at Night

Unprecedented monetary reflation, including the suppression of interest rates and rate expectations seem to have gradually spurred investors to move along the spectrum toward higher risk assets. Global economic prospects have also improved because of increased odds that Japan will finally escape deflation. The end point of the massive monetary experiment will be better economic growth, even though the path has not been smooth and will remain historically slow to develop. It has been difficult to spark a global trade upswing, given the recession in Europe and flat revival in emerging market growth.

There is certainly no shortage of things to worry about – investor confidence has been repeatedly undermined by bank turmoil, debt crises and double dip recession scares. Although monetary authorities are battling hard against the forces of debt deflation, their efforts to reflate economic conditions have resulted in the use of aggressive and unorthodox policies, thus increasing uncertainty and fears regarding the ultimate conclusion. In our opinion, stocks remain undervalued in relative terms despite the extended bull market. This is especially true given that the economic backdrop continues to slowly improve.

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.

Weekly Top Themes

1. **Broad-based inflation weakness was revealed by the April Consumer Price Index (CPI) report[2]:** The headline inflation number fell 0.4% for the month; core inflation rose 0.1%. For the trailing twelve months, headline inflation was up 1.1% and core inflation up 1.7%. These were the smallest 12-month increases since 2010.

2. **The University of Michigan Consumer Sentiment Index was up 7 points to almost 84 in the preliminary May report[3]:** The latest reading was still low by historical standards; however, it was the best thus far during the expansion. We have been surprised by the resiliency of consumer spending in the face of the tax

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increase that began at the start of the year. The recent improvement in sentiment appears to be a positive sign for consumption as we look ahead.

3. **A new report from the Congressional Budget Office suggests that deficits are likely to grow at a much slower pace in 2013 and 2014[4]:** Since deficit spending has been seen to be a major impediment to economic growth and the stock market, this was good news for the economy and the market.
4. **The biggest challenge for the Obama administration is legislative activity because this year should be the sweet spot in its second term:** The recent scandals, combined with animosity created by the fiscal cliff negotiations, could sink the legislative agenda on Capitol Hill. However, this may not equate to a negative for equity markets because the improving deficit is pushing off the debt ceiling issue by six months.

The Big Picture

We have witnessed one of the biggest mid-cycle re-ratings of global equities in over forty years. U.S. stock prices have rallied more than 30% since the 2011 lows,while earnings have been almost flat and dividends have increased. [5] Although we believe equities still look cheap compared to bonds and cash, equities no longer appear inexpensive when comparing to their own history. We anticipate markets will make further gains, supported by moderate earnings growth and dividend increases, but valuations now imply less impressive gains moving forward. Equities and bonds should sell off if the Fed hints at a reduction in its monthly bond purchases. In the meantime, the rise in equities, decline in gold, stronger U.S. dollar and uptick in Treasury bond yields make sense in the context of slowly improving economic growth.

2013 Performance Year to Date

	Returns	
	Weekly	YTD
S&P 500	2.14%	17.89%
MSCI World Ex U.S.	0.31%	10.70%
MSCI Emerging Markets	-0.34%	0.07%

Source: Morningstar Direct, as of 5/17/13. 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.

"Stocks are likely to continue higher, but at some point this will require further earnings gains."

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1 Source: Morningstar Direct, as of 5/17/13. **2** Source: Bureau of Labor Statistics, "Consumer Price Index – April 2013," May 16, 2013, http://www.bls.gov/news.release/cpi.nr0.htm. **3** Source: Bloomberg, "Consumer Sentiment Index in U.S. Rose to 83.7 in May," May 17, 2013, http://www.bloomberg.com/news/2013-05-17/consumer-sentiment-index-in-u-s-rose-to-83-7-in-may-from-76-4.html. **4** Source: Congressional Budget Office, "Updated Budget Projections: Fiscal Years 2013 to 2023," May 14, 2013, http://www.cbo.gov/publication/44172 **5** FactSet and Standard & Poor's, as of 5/17/13.

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.

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GPE-BDCOMM3-0513P