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# Brexit clarity, reduced trade tensions may bode well for equities


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*Equity markets staged a solid recovery in 2019, as several key macro challenges from the previous year receded and new tailwinds emerged. Although risks remain, a number of positive signals lead us to a more constructive outlook for 2020.*

## KEY TAKEAWAYS

- Within U.S. sectors, information technology performed best for the quarter, followed by health care and financials. Consumer staples, utilities and real estate lagged.
- Key macro and political risks have faded somewhat, but certainly haven't disappeared.
- We favor cyclical companies benefiting from improving global leading economic indicators, as well as undervalued, underappreciated, high quality companies that can grow dividends.

## IMPROVING TRENDS SUPPORT A MORE CONSTRUCTIVE VIEW

After nearly two years of decline, global economic growth may be close to bottoming. While data in certain countries have yet to improve, leading indicators overall have stabilized and/or turned higher in most major regions. The global economy was supported in 2019 by a strong service sector and resilient consumers, offsetting weakness in manufacturing. Central bank monetary easing also contributed to economic stability last year, and we expect the boost from lower interest rates to kick in further over the next six to nine months. Although expectations for 2020 global growth were revised downward in 2019, estimates are still trending at a solid 3.3% rate. Many emerging markets (EM) economies are showing signs of expansion, which is encouraging for global growth overall and for capital markets.

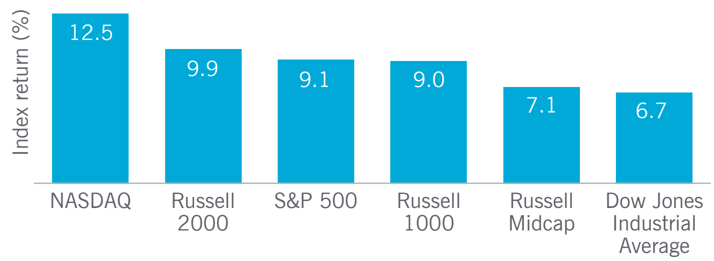
Key macro and political risks have faded somewhat, but certainly haven't disappeared. Progress on U.S./China trade and Brexit has reduced two major headline risks for investors. While trade relations between the U.S. and China may have improved, with the two countries signing a phase-one deal on 15 Jan 2020, tension—and ambiguity—remain. The agreement ushers in a fragile truce that involves only modest concessions on both sides. To significantly help the global trade outlook, many more issues will need to be hashed out by the world's two largest economies. The Brexit outcome is also looking better, as the likelihood of a "no deal" scenario has shrunk following U.K. Prime Minister Boris Johnson's huge electoral win with a Conservative Party majority. The U.K.'s departure from the European Union (EU) will still inflict economic damage, but less than initially feared had the worst case Brexit prevailed.

The recent U.S./Iran conflict represents another geopolitical flashpoint for markets. The upcoming U.S. presidential election in November is also likely to provide a new source of uncertainty as the campaign unfolds. Overall, however, we believe the macro risks facing global economies and capital markets are less severe than we would have expected a quarter ago, leading to our more constructive outlook for 2020.

## U.S.: DON'T HEAD FOR THE EXITS YET

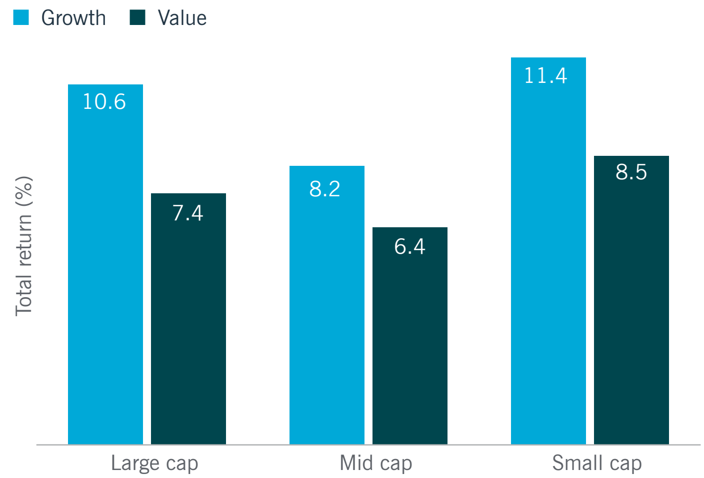
With three Federal Reserve (Fed) rate cuts in four months during 2019, concerns of an imminent U.S. recession were reduced considerably. Against this backdrop, the broad-market S&P 500® Index rose to all-time highs. Our current assessment continues to indicate that we are late in the U.S. business cycle, a view we have held over the past few years.

### U.S. index returns were strong across the board



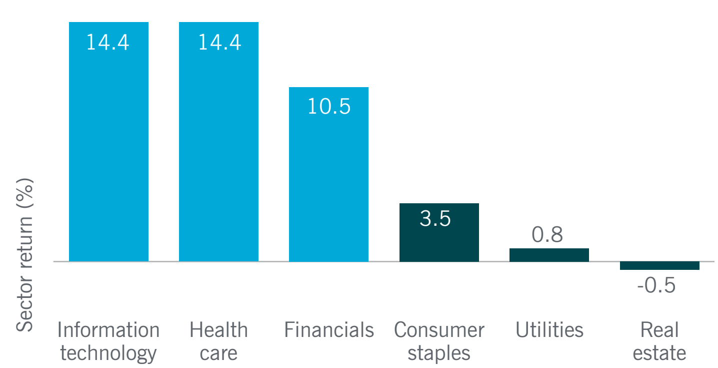

Data source: FactSet, 1 Oct 2019 to 31 Dec 2019. **Past performance is no guarantee of future results.** Indexes are unmanaged and unavailable for direct investment.

### Growth beat value in all market cap sizes




Data source: FactSet, 1 Oct 2019 to 31 Dec 2019. **Past performance is no guarantee of future results.** Representative indexes: Large Cap: Russell 1000® Growth Index and Russell 1000® Value Index; Mid Cap: Russell Midcap Growth Index and Russell Midcap Value Index; Small Cap: Russell 2000® Growth Index and Russell 2000® Value Index. Indexes are unmanaged and unavailable for direct investment.

### Tech and health care ruled, while real estate fell




Data source: FactSet, 1 Oct 2019 to 31 Dec 2019. **Past performance is no guarantee of future results.** Data based on GICS® sectors from the S&P 500® Index. Chart shows the three top- and bottom-performing sectors. Indexes are unmanaged and unavailable for direct investment.

That said, some potential concerns have eased recently. The most noticeable is that the U.S. yield curve—measured by the spread between the 3-month and 10-year Treasury yields—is no longer inverted. Historically, an inverted yield curve has been a classic recession signal, and the steepening of the curve since summer 2019 suggests the odds of recession have declined.

Consumers, who drive more than two-thirds of U.S. economic activity, remain in good shape. For the time being, the unemployment rate remains well below 4%. The labor market has created an average of more than 180,000 jobs over the most recent three months, and initial jobless claims are at a 50-year low. Consumer confidence is still high, and personal consumption grew at roughly 3% in the latest quarter.

We acknowledge that other measures continue to reflect the aging business cycle. Most output-gap estimates, for example, suggest that the U.S. economy is already operating at full capacity. There are signs of weakness in manufacturing employment, particularly in Pennsylvania, Wisconsin, Michigan and Ohio—states levered to exports driven by trade. It's increasingly clear that the U.S./China trade war and related slowdown in global growth have had a negative impact on U.S. industrial production and manufacturing job growth. Both business investment and CEO confidence have deteriorated. Investment spending fell almost 3% year-over-year in the most recent quarter. While we believe the recent trade détente will boost confidence (and therefore spending), the impact will probably be small. In our view, the trade dispute between the U.S. and China is likely to persist for many years, given the complexity of the underlying issues.

As we consider the range of possible outcomes for the U.S. stock market in 2020, it's useful to look at how earnings and valuations have changed. In 2019, the S&P 500 returned approximately 32%. Higher price-earnings multiples (valuations), rather than growth in company earnings per share (EPS), were responsible for most of this return. Current consensus estimates call for earnings growth of around 10% in 2020. Historically, most analysts have tended to start the year with overly optimistic expectations. Based on this, we think it's prudent to shave 4 to 5 percentage points off this year's initial EPS forecasts to arrive at a more realistic growth rate.

Assuming global economic growth doesn't slow significantly and the trade war doesn't re-escalate, we think investors should expect the U.S. equity market to generate total returns, including dividends, in the mid-single-digit range in 2020.

## CHINA: NEAR-TERM TRADE DEAL, LONGER-TERM PLANS

In addition to almost six months of widespread anti-government protests, Hong Kong has been hit by a slowdown in Chinese economic growth. The protests, while smaller in terms of the number of demonstrators, are much more violent and focused. The intensifying confrontations have been especially damaging to the tourism, retail, transportation and property industries. This is clearly evidenced in 2019's inbound tourist numbers, which declined 44% year over year. Despite the announcement of government stimulus measures, Hong Kong faces a prolonged recession unless this issue can be resolved.

Meanwhile, in 2019 China's real GDP growth slowed to its weakest level in at least 30 years. Based on this data, we expect Beijing to lower its 2020 GDP growth target to a range of 5.5% to 6.0%, down from 6.0% to 6.5% last year. To achieve its 2020 goal, the government will still need to increase fiscal stimulus through various measures, including spending on infrastructure projects, its decade-long driver of economic growth. The People's Bank of China cut its benchmark interest rate to stimulate lending and also reduced its reserve requirement ratio for all banks by 50 bps. All of these measures have been taken in part to counter the negative economic impacts of the trade war with the U.S. and the continuing street protests in Hong Kong.

We expect market volatility to remain elevated in the near term, reflecting this uncertain environment. President Trump's decision to sign a bill supporting the Hong Kong protesters could strain U.S./China relations, potentially hindering future trade talks. Further, there's been little tangible progress on long-standing "hot button" issues such as forced technology transfer, intellectual property theft and opening Chinese markets to U.S. companies. Accordingly, we remain highly selective with regard to investing in Chinese stocks.

## EUROPE: AVOID THE UNPREPARED

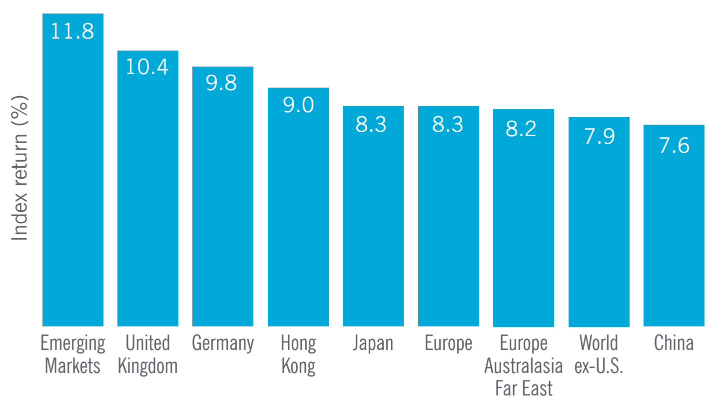
After some short-term weakness, the economic picture in Europe appears to be stabilizing, and composite leading economic indicators are beginning to point to the possibility of recovery. The European economy (Germany in particular) continues to be inventory-led, and as such is highly levered to global trade and growth. The key complication remains political risks, with the final outcome of the Brexit deal still the primary short-term uncertainty.

As noted earlier, Boris Johnson's victory and the securing of a Conservative majority in Parliament has greatly lowered the risk of a "hard" Brexit. In the meantime, company valuations have retreated to such low levels that they offer both decent downside protection in the unlikely event of a worst-case Brexit scenario and significant upside potential in earnings and price on any positive news flow. Moreover, company management teams have had well over three years to develop contingency plans for Brexit. If they have failed to do so, they have no one to blame but themselves and we think these stocks should be avoided.

U.K. companies have slowed capital spending growth over the past decade amid decelerating economic expansion and heightened geopolitical tensions. There is now debate over whether management teams will ever return to the heady days of yore when such business expenditures contributed significantly to economic growth. Capital allocation today tends to focus on technological enhancement, either in the form of improving efficiency of internal systems or offering new/improved products and services. In our view, companies with free cash flow that are allocating capital to develop or expand into overseas markets represent better investment opportunities.

We have concluded that Europe's economy appears to have stabilized after downshifting for 18-plus months, and this development is generally good for capital markets. On the other side of the ledger, some immediate risks remain, including a weak banking system, the potential for U.S. protectionism to spread beyond China to the European Union and the still-to-be-determined details of the final Brexit deal. These issues are now likely discounted in current stock prices but should be factored into investment decisions in 2020.

### The emerging markets and U.K. led non-U.S. returns




Data source: Morningstar Direct, Bloomberg, L.P., 1 Oct 2019 to 31 Dec 2019. **Past performance is no guarantee of future results. Representative indexes: China:** Shanghai Stock Exchange Composite; **Emerging Markets:** MSCI Emerging Markets Index; **Europe/Australasia/Far East:** MSCI EAFE Index; Europe: Euro Stoxx 50 Index; **Germany**: DAX Index; **Hong Kong:** Hong Kong Hang Seng Index; **Japan:** Nikkei 225 Index; **United Kingdom:** FTSE 100 Index; **World:** MSCI World ex-U.S. Index. Indexes are unmanaged and unavailable for direct investment.

## JAPAN: GOLD MEDAL OPPORTUNITY?

Growth in the Japanese economy continues to be steady but unspectacular, supported by consumption. The economy has been helped by increased spending related to the 2020 Tokyo Olympics and accelerated retail purchases ahead of the higher consumption tax (VAT) implemented on October 1. Both developments helped offset the headwind of slowing regional growth. We anticipate that Japan's 2020 GDP growth will mirror 2019, at around 1%.

The Bank of Japan (BOJ) continues to reaffirm its accommodative policy stance. However, the pace of balance sheet expansion is expected to slow, since the BOJ's holdings of Japanese government bonds already account for a not insignificant 43% of its outstanding debt. We forecast Japanese inflation will remain shy of the BOJ's 2.0% target, hampered by weak wage growth, despite a relatively low unemployment rate of 2.2%.

Japanese equities rallied and the yen weakened through the end of 2019, reflecting the easing of U.S./China trade tensions. These developments contributed to a more positive outlook for Japan's semiconductor industry and should bolster exports. Among the forward catalysts we see for this market are continued policy support from the BOJ, fiscal stimulus (particularly around the Olympic games) and increased company management focus on shareholder value, including stock buybacks and higher dividend payouts.

## ASIA PACIFIC EX-JAPAN: TIME TO STAND OUT

Asian equities gained during 2019. Returns benefited from better market sentiment starting in late September, thanks to a de-escalation in the U.S./China trade conflict and continued Fed rate cuts.

Taiwan has been among Asia's best-performing markets, as its manufacturing industry shows signs of stabilizing. The country's manufacturing PMI (purchasing managers' index) rose in October after contracting for most of 2019. Taiwan's central bank has subsequently raised its growth forecast. Overseas demand, which had been anemic, has picked up ahead of the rolling out of next-generation 5G technology and the launch of new mobile devices.

In India, 2019 GDP growth of 5.7% was at its slowest pace in six years. The softer growth has been quite broad-based, with less robust consumption and services, exacerbated by a drop in lending by non-bank financial companies and weaker global demand. This slowdown prompted the government to implement a surprise corporate tax cut, from 30% to 22%, in September. In addition, the Reserve Bank of India cut interest rates to their lowest levels since 2011.

Improving economic indicators in South Korea included a drop in unemployment during 2019. The government plans to boost fiscal spending by 8% in 2020, with measures to support innovation, social welfare and jobs. In volume terms, semiconductor exports are growing again for the first time since the second quarter of 2019. The Bank of Korea has also been proactive in cutting its base rate to a historical low of 1.25%.

While Indonesia is one of Asia's least trade-dependent economies, it's not immune from slowing global growth. Falling commodity prices have certainly been a headwind. Consequently, infrastructure spending has slowed. Despite this, we believe Indonesia's outlook for 2020 and 2021 is relatively positive. There are tangible signs of a new infrastructure cycle in 2020, as President Jokowi launches a new round of priority projects following his re-election.

## EMERGING MARKETS: CATALYSTS MAY LEAD STOCKS HIGHER

EM equities have underperformed their developed market counterparts over the past nine years, hampered by a strong U.S. dollar, as well as slowing corporate earnings and GDP growth relative to developed markets. Several of these headwinds receded somewhat in 2019, and we believe they will continue to do so in 2020. This should support improved EM equity performance relative to developed markets.

A key driver of the recovery in EM corporate earnings for 2017 and 2018 was revenue gains, together with better margins. At first glance, 2019 seemed to mark a pause in those trends. A closer examination, however, shows that memory chip stocks accounted for much of the EPS decline, while EM earnings in areas other than the information technology and commodity sectors were largely respectable. Given expectations for an improving global economy in 2020, we foresee a more broad-based recovery in corporate earnings growth, which should bolster EM equities.

## OUTLOOK

### *Moderate but sustainable growth in 2020*

The global economy is likely to continue expanding at a moderate but sustainable pace in 2020. Based on this view, we believe bond yields will be relatively contained, and—while balancing investor risk versus reward—equities will offer investors the potential for larger gains. Within a diversified equity portfolio, we would lean toward investment in companies that are beneficiaries of reduced U.S./China trade risk, a favorable Brexit deal and ongoing global growth. In addition, we favor cyclical companies benefiting from the improvement in global leading economic indicators, as well as undervalued, underappreciated, high quality companies that can grow dividends.

**For more information, please visit us at nuveen.com.**

#### Endnotes

#### Sources

Index Performance: FactSet; European Corporate Earnings: I/B/E/S; U.S. Corporate Earnings: Standard & Poor's; Employment: RBC Global Asset Management; Russell Indices: FactSet, Russell Investments

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#### Glossary

**Euro Stoxx 50** is an index of 50 of the largest and most liquid stocks of companies in the eurozone. **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. **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. **MSCI ACWI-All Country World (ex U.S.) Index** is a market capitalization weighted index designed to provide a broad measure of global equity market performance excluding the U.S. MSCI EAFE Index is a free float-adjusted market capitalization weighted index designed to measure developed market equity performance, excluding the U.S. and Canada. **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. **Russell 1000® Index** is an index of approximately 1,000 of the largest companies in the U.S. equity markets. **Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher expected growth values. **Russell 1000® Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. **Russell 2000® Index** measures the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. **Russell 2000® Growth Index** measures the performance of the large-cap growth segment of the Russell 2000 Index. **Russell 2000® Value Index** measures the performance of the large-cap value segment of the Russell 2000 Index. **Russell Midcap Index i**s a market capitalization weighted index comprised of 800 publicly traded U.S. companies with market caps of between $2 and $10 billion. **Russell Midcap Growth Index** measures the performance of the large-cap growth segment of the Russell Midcap Index. **Russell Midcap Value Index** measures the performance of the large-cap value segment of the Russell Midcap Index. **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. **Nasdaq Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. **S&P 500® Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy.

#### A word on risk

All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. Equity investments are subject to market risk or the risk that stocks will decline in response to such factors as adverse company news or industry developments or a general economic decline. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, tax risk, political and economic risk, and income risk. As interest rates rise, bond prices fall. Non-U.S. investments involve risks such as currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. This report should not be regarded by the recipients as a substitute for the exercise of their own judgment. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.



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