10 PREDICTIONS FOR 2020

Uncertainties diminish, but markets struggle

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The biggest question heading into 2020 is whether the good news is already baked into stock prices. I fear much of it may be.

From my standpoint, 2020 is shaping up to be an odd year for making predictions. For most years, especially since the financial crisis, the economic outlook appeared cloudy as investors worried about recession. But it was still possible to make a strongly positive case for stocks. That doesn't seem to be the case this year: In fact, for 2020 I have an easier time predicting better economic growth than better market conditions.

To be clear, I'm not calling for the end of the bull market in 2020. But several factors, including the incredibly strong run for stocks in 2019 that pushed valuations higher, make it tough to call for another year of double-digit equity returns. In many ways, upside and downside risks for stocks appear fairly well balanced.

THE U.S. EQUITY BALANCING ACT

The positives ...	... and the negatives
Economy/earnings improving	Peak profit margins
No sign of a recession	Rich valuations
Global economy improving	High corporate leverage
Manufacturing recovery	Trade protectionism
Improving trade outlook	Limited central bank ammunition
Global monetary easing	Election uncertainty/polarization
Fear of missing out on the rally	Significant geopolitical uncertainty

At the end of the day, though, I think economic growth and corporate earnings growth will improve modestly in 2020. Normally, that would be sufficient to call for stocks to appreciate. But this year, valuations and a number of political uncertainties could make it tougher for investors to find opportunities.

In the following pages, I offer my specific predictions for the coming year and discuss some important themes that may emerge. But for now, I wish all of you a Happy New Year.

Best regards,

Robert C. Doll, CFA

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2019 recap
Choppy, but not frustrating

THE THEME FOR OUR 2019 10 PREDICTIONS WAS "CHOPPY AND FRUSTRATING, BUT NO RECESSION." We got the "choppy" and "no recession" parts right, but it's hard to argue that the past year was frustrating for investors, with stocks experiencing one of their best years in history. Thanks in part to a somewhat surprising turn in Federal Reserve policy, U.S. stocks returned more than 30% for 2019 (as measured by the S&P 500 Index) and global stocks weren't far behind.[1]

LOOKING BACK ON 2019, IT SEEMS WE CAN BREAK THE YEAR INTO THREE PHASES: Phase 1 was the recovery from the horrible conclusion of 2018; phase 2 was the third quarter flirtation with recession in the U.S. and globally as manufacturing activity deteriorated significantly and trade worries came to the forefront; and phase 3 was the recovery and final year-end rally in stocks and other risk assets.

THE YEAR ALSO EXPERIENCED THREE NOTEWORTHY DEVELOPMENTS THAT SET THE STAGE FOR 2020: 1) the massive Fed reversal from tightening into year-end 2018 to actually cutting rates three times in 2019, 2) the slow and steady cutting of earnings expectations and 3) the roller coaster ride associated with the U.S./China trade dispute.

AS THE YEAR DRAWS TO A CLOSE, THE BROAD MACRO BACKDROP LOOKS IN MANY WAYS BETTER THAN IT DID 12 MONTHS AGO. The global economy appears to be on more solid footing, thanks largely to an impressively strong U.S. consumer sector and labor market. But we worry about relatively weak global manufacturing and trade and the tendency of the yield curve to invert.

OUR BASE-CASE VIEW IS THAT NEITHER THE U.S. NOR GLOBAL ECONOMIES ARE LIKELY TO SLIP INTO RECESSION IN THE COMING 12 MONTHS. And some of the big risks, like trade disputes, Brexit uncertainty and U.S. budget negotiations seem clearer now than they were a year ago. In fact, one of the biggest risks today may be that stocks have already priced in much of the good news.

2019 highlights

The Fed shifted gears and cut interest rates, helping stocks and other risk assets.

The year ended with less uncertainty over issues such as U.S./China trade policy and Brexit.

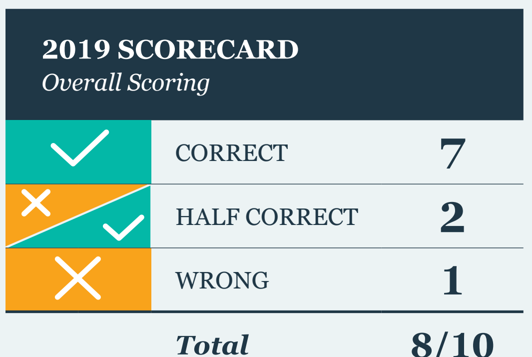
Stock prices soared through much of the year, setting multiple new records.

2019 lowlights

U.S. economic growth slowed, partially as the effects of the 2017 tax cuts faded.

Corporate earnings struggled, in part due to ongoing trade policy uncertainty.

A fractured U.S. political backdrop dominated the year — and that doesn't seem likely to change in 2020.



2019 SCORECARD
Overall Scoring

✓	CORRECT	7
✗ ✓	HALF CORRECT	2
✗	WRONG	1
	Total	**8/10**

We based our 2019 predictions around the theme that markets and economic data would be choppy, but we would avoid a recession or an end to the bull market. That was pretty much the case. And as such, most of our predictions came to pass over the course of the year.

1

The U.S. expansion becomes the longest in history despite GDP slowing to a still-above-trend increase of 2% to 2.5%.

Growth slowed slightly in 2019, but the final data will likely show that the U.S. grew at just over 2% for the year.[1] And as of June 30, this current economic expansion became the longest in U.S. history.[2]

2

Unemployment bottoms in 2019 while wage growth continues to rise.

The last reading available showed unemployment at 3.5%, close to a 50-year low.[3] Wage growth has also continued to accelerate. We are starting to see some preliminary signs of higher inflation, which will be something to watch in the year ahead.

3

The Treasury yield curve flattens and credit spreads widen due to late cycle concerns.

Bond markets were quite volatile in 2019, causing this prediction to fall into the half-correct category. The yield curve inverted on-and-off and flattened during 2019 (but did end the year sloped positively), while credit spreads tightened along with rising stock prices.[1]

4

Corporate earnings growth estimates weaken for 2019 and 2020 as both revenue and profit pressures rise.

Both revenues and profits have come under pressure this year, causing earnings growth expectations for both 2019 and 2020 to fall by around 7% compared to the start of the year.[1] As we look into next year, we are concerned that corporate earnings expectations may still be too high, setting up the possibility of disappointments.

5

U.S. equities experience a positive return, but fail to reach record highs for the first time in 10 years.

We'll also wind up getting this one half-correct. Stocks soared higher for the year, setting new records. For all of 2019, the S&P 500 Index was up 31.5%.[1]

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> *Despite some choppiness along the way, 2019 will go down in history as one of the best ever for stocks.”*

6

Non-U.S. stocks outperform U.S. stocks as the dollar sags.

This turned out to be the sole prediction we are getting wrong. Non-U.S. growth has been slower than we expected, and the U.S. dollar has risen. For the year as a whole, the S&P 500 Index (up 31.5%) was well ahead of the MSCI World Index ex-U.S. (up 23.2%).[1]

7

The information technology, financial and health care sectors outperform utilities, REITs and materials.

We were getting this one wrong for most of the year, but a sharp rotation to cyclical areas of the market in the fourth quarter helped push this one to the correct category. For all of 2019, a basket of our preferred sectors was up an average of 34.4% while a basket of our less-preferred was up 26.6%.[1]

8

The annual federal budget deficit approaches $1 trillion, a level unprecedented absent a recession.

Lower taxes and increased spending pushed the deficit to levels never seen in non-recessionary years. For the fiscal year ending September 30, the Congressional Budget Office reported a deficit of over $1 trillion. Estimates for the coming years are climbing even higher.

9

U.S. and global politics spark more market volatility as the cold wars within the U.S. and with China persist.

Trade issues, Brexit worries, geopolitical hotspots and growing political and social discord have all been causing market volatility. And sadly, we don’t see that backdrop fading any time soon.

10

A double-digit number of Democrats run for president while President Trump is challenged within his own party.

Before some marginal candidates started dropping out, well over 20 Democrats announced runs for the presidency. And at this point, Mark Sanford, Joe Walsh and Bill Weld have announced for the GOP. Add in the escalating drama of the impeachment hearings, and politics certainly aren’t boring. And all of that before things really heat up in an election year.

2019 by the numbers

FOR MUCH OF 2019, STOCKS REMAINED STUCK IN A BROAD TRADING RANGE. Markets were up sharply in the first half of the year, before trailing off over the summer and early autumn. The initial jump in prices reflected an unwinding of the dramatic correction that came at the close of 2018. In the middle of 2019, recession fears grew and trade tensions spiked, which stalled the rally. As recently as three months ago, stock prices were still pretty much at the same level they were at the start of 2018.

IN THE FOURTH QUARTER, HOWEVER, STOCK PRICES FINALLY BROKE OUT OF THEIR RANGE TO POST DECISIVE NEW HIGHS. Equities experienced a strong fourth quarter, with the S&P 500 Index up 9.1%, which pushed returns for the year as a whole to an impressive 31.5%.[1] Small cap stocks trailed for much of the year, but still managed to rise 25.5% for 2019 (as measured by the Russell 2000 Index). Every sector of the market posted gains for the year, with technology (up an amazing 50.3%) leading the way and energy (up 11.8%) being the worst relative performer.

OUTSIDE OF THE U.S., RESULTS WERE ALSO SOLID, EVEN IF GLOBAL MARKETS TRAILED ON A RELATIVE BASIS. U.S. growth outpaced most of the rest of the developed world, while emerging markets were held back by trade policy uncertainty and a difficult environment for energy producers.

EVEN MORE NOTABLE THAN THE STRONG SHOWING AMONG STOCKS AS A WHOLE, HOWEVER, WAS THE SHIFT IN MARKET LEADERSHIP THAT OCCURRED TOWARD THE END OF THE YEAR. Starting at the end of the third quarter, we witnessed a rotation away from momentum, growth styles, defensive stocks and higher quality toward value, smaller caps and cyclical areas of the market thanks to a rebound in government bond yields and signs that trade tensions may be easing. It is too early to say whether this shift is temporary or the start of a prolonged leadership change. But if economic sentiment continues to improve, and especially if manufacturing data recovers, we would be more inclined to believe it is the latter.

OUTSIDE OF STOCKS, OTHER ASSET CLASSES ALSO ENJOYED GOOD PERFORMANCE IN 2019. The yield on the 10-year Treasury fell to near-record lows in early September before rising slightly to end the year at 1.92% (compared to 2.68%, where it was at the start of the year).[1] The overall fall in rates during the year helped the Bloomberg Barclays U.S. Aggregate Bond Index rise by 8.7% in 2019.[1] Cash trailed both stocks and bonds in 2019, returning a relatively modest, but still positive, 2.3%.[1]

KEY INDEX PERFORMANCE 2019 TOTAL RETURNS

Index	Return
S&P 500 Index	31.5%
Dow Jones Industrial Average	25.3%
NASDAQ Composite	36.7%
Russell 2000 Index	25.5%
Euro Stoxx 50	26.8%
FTSE 100 Index (U.K.)	22.0%
DAX Index (Germany)	23.0%
Nikkei 225 Index (Japan)	22.4%
Hang Seng Index (Hong Kong)	13.6%
Shanghai Stock Exchange Composite Index (China)	23.8%
MSCI World Index (ex-U.S.)	23.2%
MSCI Emerging Markets Index	18.9%
Bloomberg Barclays U.S. Aggregate Bond Index (bonds)	8.7%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	2.3%

Source: Morningstar Direct, Bloomberg and FactSet as of 31 Dec 2019. 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 indexes are unmanaged and unavailable for direct investment.

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2020 outlook:
Economy improves, but stocks struggle to make gains

ONE YEAR AGO, INVESTORS WERE VERY WORRIED ABOUT A GLOBAL RECESSION, BUT THOSE RISKS APPEAR TO HAVE FADED. In fact, we think investors may have grown too optimistic over prospects for stronger growth, as reflected by rising stock prices. We think risks remain, especially regarding the manufacturing sector and global trade levels. Weak manufacturing and trade could potentially act as a drag and significantly slow down global economic momentum. We think it is more likely that the strong consumer and service sectors could provide a lift to manufacturing data. But so far evidence of that scenario has been scant.

THE MAIN CULPRIT BEHIND ANY ECONOMIC WEAKNESS CONTINUES TO BE THE RISE IN PROTECTIONISM AND BROAD TRADE POLICY UNCERTAINTY. At present, equity prices reflect a better trade environment, and we hope those signals are correct. A reduction in tariff levels (or even easing trade tensions and more clarity around future policy) would be bullish for stocks. If corporate management teams were more confident about trade issues, they would be more willing to invest in their businesses, which would be a positive for corporate earnings and profits.

FOR ITS PART, THE FED SIGNALED IT IS LIKELY TO REMAIN ON THE SIDELINES. With economic growth appearing to improve modestly, there's not much of a case for additional cuts. And the Fed isn't likely to raise rates unless inflation ticks notably higher. This backdrop, combined with a contentious election season, leads us to believe the Fed will likely stay on hold for the coming quarters.

AS SUCH, WE ARE ONLY MODESTLY CONSTRUCTIVE ON EQUITIES HEADING INTO NEXT YEAR. This doesn't mean, however, that we are not finding opportunities. As our 2020 predictions indicate, we are seeing better relative value in some non-U.S. areas than in the United States. And we are leaning toward areas of the market that can benefit from a modest improvement in economic growth, those with healthy balance sheets and those that can put high levels of free cash flow to work. We also think the recent trend of value outperforming growth could cause value to win out over the year as a whole. In sum, this looks to be a stock-picker's environment where selectivity is key.

ADDITIONALLY, WE POINT TO SEVERAL THEMES WE THINK MAY WIN OUT OVER THE COURSE OF 2020. Specifically, we think focusing on factors such as high free cash flow, inexpensive valuations, the ability to grow top-line earnings and an eventual tilt toward non-U.S. sources of revenue would benefit investors.

Positive signals for 2020 ...

The geopolitical risks that dominated 2019 (trade issues and Brexit) seem to have faded.

Global economic growth appears to be ticking up, and manufacturing is showing some signs of life.

Monetary policy is more accommodative now than it was at the start of 2019.

... and risks to consider

Stock valuations appear full, which may make it tough for equities to move notably higher.

Corporate earnings are likely to disappoint in 2020.

The U.S. political backdrop is likely to contribute to market volatility in the year ahead.

TEN PREDICTIONS FOR 2020

Uncertainties diminish, but markets struggle

As our 2020 theme suggests, we see both positives and negatives for stocks as we head into the coming year. Some key risks look more manageable, while other fundamental factors may be working against the markets. This looks to be a year in which investment selectivity will be critical.

1

The world avoids recession in 2020 as U.S. GDP grows over 2% and global GDP grows over 3%.

If the U.S. economy avoids a recession in 2020, this would mean an unprecedented twelfth year of economic growth.[4] We expect significant monetary easing in 2019 will translate into decent, if unspectacular, growth in 2020. We still see several risks, including a rise in delinquency rates on consumer loans and a drop in banks' willingness to lend. But to us, the positives outweigh the negatives.

2

Inflation and the 10-year U.S. Treasury yield end the year above 2% as the Fed stays on hold through the election.

Low inflation has helped prolong the current cycle, and the Fed would actually like to see inflation move higher. This prediction is based on assumptions that 2019 monetary stimulus will raise both real growth and inflation measures to some degree. Several factors point to modestly higher inflation and interest rates: wage pressures, rising inflationary expectations, an uptick in manufacturing, the easing of the trade war and fiscal stimulus from multiple countries.

3

Earnings fall short of expectations, partially due to rising wage rates.

2018 earnings exceeded expectations, due to both the benefits of the 2017 tax cuts and increasing profit margins. In 2019, in contrast, earnings faded due to mediocre top-line growth and disappointing profit margins. We expect negative earnings revision activity to persist in 2020, as profit margins disappoint and wage pressures rise. Current consensus earnings growth for next year ranges from 9% to 10%.[1] Our forecast is for something closer to 5% to 6%.

4

Stocks, bonds and cash all return less than 5% for only the fourth time in 25 years.

Prediction #3 points to our cautious view on earnings. We also observe that stocks are not particularly cheap at this point, as prices rose considerably in 2019. At the same time, interest rates may rise modestly from low levels, which could cause bonds and cash to struggle. Should this all play out, all three asset classes could return less than 5%, as happened in 2005, 2015 and 2018. Needless to say, this prediction perhaps puts us furthest out on a limb.

5

Non-U.S. stocks outpace U.S. stocks as the dollar retreats.

The U.S. economy recovered more quickly post the Great Recession and also grew faster and longer, helping U.S. stocks beat non-U.S. markets for most of the past decade. Nevertheless, some reacceleration of non-U.S. growth and a weaker U.S. dollar — coupled with more attractive non-U.S. equity market valuations — lead us to believe that the U.S. markets will finally lag in 2020.

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Stocks as a whole may struggle. But we are still finding compelling investment ideas."

6	**Value and cyclicals outperform growth and defensive stocks.**	Style questions are a topic of hot debate across our equity platform at Nuveen. We feel cyclical areas of the market (such as financials) look poised for outperformance. We also think the emerging trend of value beating growth could continue long enough for value to win over the course of the year, especially since growth and defensive areas look relatively less attractive from a valuation standpoint than earlier in the cycle.
7	**Financials, technology and health care outperform utilities, real estate and consumer discretionary.**	Financial stocks remain inexpensive with improving fundamental prospects. The information technology sector should benefit from an improving global economy, a weakening dollar and new product and service cycles. The health care sector will likely gyrate with the latest political polls, but should benefit from unit growth, some pricing power and generally undemanding valuations. The other three sectors appear expensive and could experience earnings pressures.
8	**Active equity managers outperform their indexes for the first time in a decade.**	In our experience, active managers generally have a tailwind when small stocks beat big stocks, non-U.S. stocks outperform, equity returns are relatively low, value beats growth, correlations are low, economic growth improves and interest rates rise. We expect most of those conditions to favor active over passive in 2020.
9	**The cold wars within the U.S. and between the U.S. and China continue.**	The world's problems are immense and seem to be growing. Even with a phase-one trade deal, the emerging cold war between the U.S. and China undoubtedly has many more chapters to go economically and diplomatically (but hopefully not militarily). In the U.S., the have/have not gap continues to grow and the political backdrop appears to be more contentious than ever, a situation unlikely to improve during an election year.
10	**The U.S. concludes a tumultuous political year with a status quo election.**	Predicting that the Republicans would win the presidency in 2016 was certainly one of our minority views at the time, and our best guess at this juncture is that President Trump will win reelection thanks largely to a good economy. We also expect the status quo in Congress, with Democrats likely gaining a couple of seats in the Senate and Republicans regaining a handful of seats in the House.

Key themes for investors

MATCHING GOALS TO INVESTMENTS

The beginning of the year is often a time to review investment goals and adjust asset allocation decisions. We suggest focusing on the following areas as you assess your portfolio:

Expect choppy and frustrating markets: We expect economic growth will remain uneven, even as it picks up a bit. But we don't think we are heading for a recession. Given current valuations and our earnings outlooks, we are broadly neutral on stocks.

Look for tactical opportunities that may come from active management: In an environment where overall gains may be tough to come by, we think it will make a difference to focus on geographic and style differences, as well as bottom-up considerations such as cash flow and earnings sustainability. Similarly, we encourage investors to be nimble and flexible as they approach the markets.

Selectivity also matters in fixed income: With low yields and the prospect of continued rate volatility, fixed income investing has become more challenging. Investors may want to rely on active managers with the flexibility to respond to market changes and the investment acumen to remain ahead of their peers in uncertain markets. We think focusing on higher quality areas of the market makes sense, and we see value in municipal bonds.

Alternatives can play multiple roles in a portfolio: Alternative assets — including real assets, real estate and other investments — may provide diversified sources of risk, return and/or income. We also think equity strategies such as long/short or market neutral have the potential for diversification compared to long-only, benchmark-oriented investments.

Characteristics we look for when evaluating companies:

- *Free cash flow can provide flexibility to raise dividends, reinvest in the business and buy back shares*
- *Companies with the ability to generate unit growth may be advantaged over those that lack pricing power*
- *Economic sensitivity and above-average secular growth may help insulate against market fluctuations*

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Endnotes

1 Bloomberg, FactSet and Morningstar Direct

2 ISI Evercore

3 Bureau of Labor Statistics

4 Bureau of Economic Analysis

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Glossary

The **S&P 500® Index** is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy. The **Dow Jones Industrial Average** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. The **Nasdaq Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market. The **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. **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 a 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. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. The **BofA Merrill Lynch 3-Month U.S. Treasury Bill Index** is an unmanaged market index of U.S. Treasury securities maturing in 90 days that assumes reinvestment of all income.

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