Equities dropped sharply last week with the S&P 500 index losing 5.9%, its worst first trading week of the year on record.¹ Worries about slowing Chinese growth and policy uncertainty were the main culprits for the rout, and sagging oil prices triggered concerns about corporate earnings. Late in the week, markets saw a brief reprieve in light of a strong December jobs report.

Key Points

- Equity markets endured an intense downturn, but evidence suggests investors are not in panic mode.

- Markets are likely to remain volatile and sentiment bearish until Chinese policymakers demonstrate they can stabilize economic and financial conditions.

- We expect global economic growth to improve in 2016, and suggest investors maintain overweight allocations to equities.

Investors Appear Calm as More Issues Lurk on the Horizon

The S&P 500 is now down almost 8% since mid-December. Despite the magnitude of the decline, however, we are not seeing the same sort of panic and forced selling that we witnessed in August during the last China-induced turmoil. Investors seem to understand that China’s near-term issues are more about policy mistakes and less about slowing economic growth.

China remains the near-term focus for investors, but there are additional risks drawing investors’ attention. It appears that fourth quarter economic growth may have weakened a bit (we think the automotive sector softened). And the renewed slide in oil prices could pressure corporate earnings and create credit problems for financial institutions. Since we do not anticipate a specific, durable foreign exchange announcement from Chinese policymakers, we expect the next major catalyst for equity markets will be fourth quarter earnings results.
Weekly Top Themes

1. China has real fundamental issues, but the current wounds are largely self-inflicted. Large debt loads, a slowing economy, capital outflows and tighter U.S. monetary policy are all causing pain for China, but we believe the country’s financial turmoil has been brought about by policy confusion and a lack of transparency.

2. The U.S. economy is relatively insulated from China’s issue. 2015 U.S. exports to China were $118 billion, which represents less than 0.66% of U.S. GDP. As such, we think there is virtually no chance that the U.S. could “import” recession from China. If anything, cheaper Chinese goods could represent a form of economic stimulus.

3. Outside of the equity downturn, financial markets are not showing significant stress. Bond yields and spreads have remained orderly, and currency markets have not been moving sharply. This suggests that there is not a high risk of a broader global financial crisis.

4. Despite external pressures, the U.S. labor market remains strong. December jobs growth came in at a better-than-expected 292,000 with upward revisions to prior months. Unemployment was steady at 5.0%, and although average hourly earnings dropped, they are still up 2.5% for the year. The strength of the report should allay fears that economic momentum is fading and also validates the Federal Reserve’s decision to increase rates last month.

5. Corporate earnings are likely to remain soft. Fourth quarter results for the S&P 500 are expected to decline by 5%, marking the first time since the Great Recession of three consecutive quarters of contractions. Analyst predictions for first quarter results are for a meager 1% growth level.

Risks Are Evident, but We See Reasons for Optimism
For now, we expect equity markets will be dominated by issues in China, and sentiment may remain bearish until investors believe policymakers will be able to stabilize economic and financial conditions. Over the coming months, however, we expect confidence will be gradually restored, corresponding with healthier economic fundamentals. A combination of moderate economic growth, low inflation, an improving labor market, low interest rates and rising consumer spending levels should all eventually act as tailwinds for corporate earnings and for equity prices.

Despite recent severe market turbulence, we remain broadly constructive on the global economic outlook for 2016. We expect the U.S. economy to continue to expand, Europe to regain traction and Chinese growth to stabilize. For markets, we expect volatility will persist, but the combination of improving economic growth and a modest Fed tightening campaign suggests that equities are poised to outperform bonds over the next six to twelve months. As such, we continue to believe investors should hold overweight positions in equities in their portfolios.

Page 2, ©2018 Advisor Perspectives, Inc. All rights reserved.
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. 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 EAFE Index is a free-float-adjusted market capitalization weighted index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. 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.

RISKS AND OTHER IMPORTANT CONSIDERATIONS

The views and opinions expressed are for informational and educational purposes only as of the date of writing and may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The information provided does not take into account the specific objectives, financial situation, or particular needs of any specific person. All investments carry a certain degree of risk 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-investment-grade bonds involve heightened credit risk, liquidity risk, and potential for default. Foreign investing involves additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. Past performance is no guarantee of future results.

Nuveen Asset Management, LLC is a registered investment adviser and an affiliate of Nuveen Investments, Inc.

©2016 Nuveen Investments, Inc. All rights reserved.