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2019 Investment Outlook

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Economic and investment observations

1. In July, this economic expansion became the longest in U.S. history. But it has been the slowest.

2. The U.S. consumer until now has been strong (including income and hiring data). Manufacturing, trade and most of the rest of the world not so.

3. The labor market at full employment may eventually put upward pressure on wages and downward pressure on corporate profit margins.

4. The difference between the U.S. and China on trade issues seems as wide as ever.

Economic and investment observations

5. The Fed is under pressure from all sides.

6. The Trump administration is considering indexing capital gains to inflation. Lowering capital gains tax rates increases the after-tax rate of return on stocks and would support higher equity valuations.

7. Bottom up analysts' 2020 earnings forecast is +10%. We expect earnings growth at only half that pace, so more earnings downgrades are likely.

8. As third quarter earnings season approaches, we are concerned that investors are relying too much on a "Fed put," while ignoring profit downgrades. Historically, when easier monetary policy and weaker growth coincide, profit deterioration eventually wins.

Economic and investment observations

9. The odds of a progressive president (higher taxes, heavier regulation) in 2020 have increased.

10. The short-term good news is that Washington passed a budget at the debt ceiling. The bad news is the long-term deficit/debt issue got worse in the process.

11. Nearly all of the 15ish% increase in the S&P 500 this year has been driven by valuation expansion, as P/Es have risen from 14x to 17x. Lower interest rates have driven equity valuations, but the earnings growth outlook has weakened. (This is somewhat offset by S&P500 yield higher than the 30-year Treasury yield.)

12. S&P 500 yields more than 30-year Treasury.

What would make us more bullish?

1. Fed “put” dialogue lessens
2. Global manufacturing (ISMs/PMIs) rebound
3. The U.S. and China reach a trade agreement
4. The level of complacency is reduced
5. Lower prices (lower valuations)

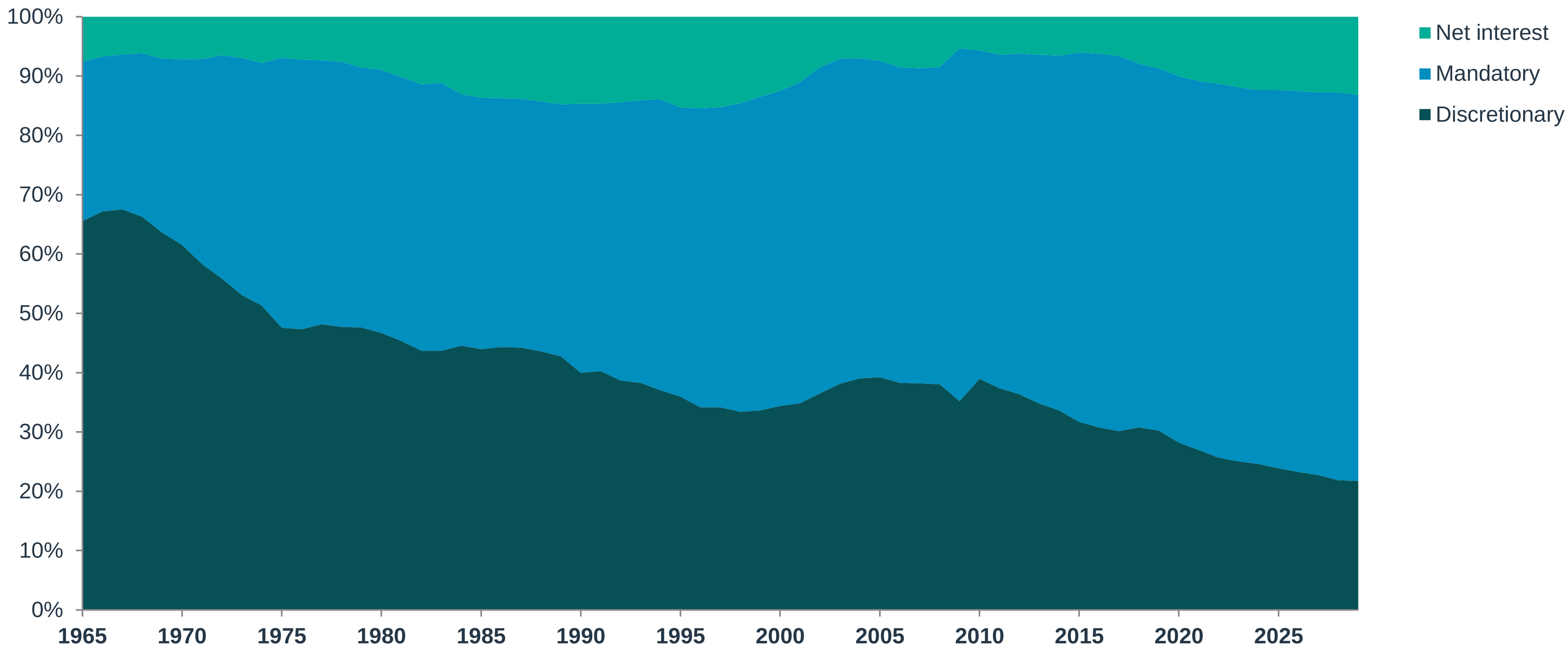
2019 Ten Predictions

Theme: Choppy and frustrating, but no recession

1. The U.S. expansion becomes the longest in history despite GDP slowing to a still-above-trend increase of 2% to 2.5%.
2. Unemployment bottoms in 2019 while wage growth continues to rise.
3. The Treasury yield curve flattens and credit spreads widen due to late cycle concerns.
4. Corporate earnings growth estimates weaken for 2019 and 2020 as both revenue and profit pressures rise.
5. U.S. equities experience a positive return, but fail to reach record highs for the first time in 10 years.
6. Non-U.S. stocks outperform U.S. stocks as the dollar sags.
7. The information technology, financial and health care sectors outperform utilities, REITs and materials.
8. The annual federal budget deficit approaches $1 trillion, a level unprecedented absent a recession.
9. U.S. and global politics spark more market volatility as the cold wars within the U.S. and with China persist.
10. A double-digit number of Democrats run for president while President Trump is challenged within his own party.

Government spending: all about entitlements

Composition of U.S. federal outlays (including CBO forecast)



Data source: CBO, Haver Analytics, DB Global Research, 1 Jan 1965 to 31 Dec 2029. Used with permission. CBO stands for Congressional Budget Office.

What to do?

1. Expect choppy markets, but a rally if no recession
2. Focus more on alpha, less on beta
3. Lean in when markets get hit, let some go on big moves up
4. Diversify asset classes and geographies
5. Focus on quality and free cash flow
6. Watch inflation carefully
7. Consider an absolute return strategy to complement market exposures

Current themes and sector highlights

As of 30 Sep 2019

Our views on themes in the economy and financial markets help inform the research process.

Themes

Positives	• Anti-imminent recession/economic sensitivity • Free cash flow generation • Healthy consumer • Innovators/pricing power/stable or rising profitability • Overweight domestic earnings
Negatives	• Economically defensive • Negative free cash flow • De-emphasize foreign trade • Shun expensive • De-emphasize weak balance sheets
2019 vs. 2018	• Higher quality/predictability • More value friendly • More multi-nationals eventually

Source: FactSet. See nuveen.com for more information.

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