2016 Ten Predictions

Risks Intensify, but Reasons for Optimism Persist

NUVEEN ASSET MANAGEMENT

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Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.

Brexit Triggers Economic and Political Uncertainty

The first half of 2016 can be divided into three parts. The first six weeks were marked by deflation fears, resulting in a sharp sell-off in equities. A two-month rally followed, as investors realized economic conditions were not as bad as previously feared. Equities traded sideways for the last few months as investors digested mixed economic and earnings news and anticipated a Federal Reserve rate hike.

Then came Brexit. United Kingdom voters surprised the world by choosing to leave the European Union, throwing markets into turmoil. Broadly, we think the decision is negative for the UK and eurozone economies, and will put downward pressure on European equities. Deteriorating economic conditions may exert further deflationary pressures on an already-fragile global economy. The key metric to watch for will be a decline in global trade levels.

Perhaps even more important than the economic effects are what the Brexit decision means politically. Brexit raises questions about the EU model of economic unity. The political influence of populist leaders has been rising throughout the world in recent years, and we believe the possibility of a broader move toward nationalist, isolationist and protectionist policies would be a negative for global economic growth and risk assets, including equities. This trend bears watching.

Despite these downsides, we believe the U.S. economy remains solid. While the May jobs report was disappointing, employment rebounded in June and the unemployment rate is less than 5%.[1] This has boosted consumer spending, with retail sales climbing modestly over the last few months.[2] The recent firming of oil prices is also positive for the United States. Higher oil prices should help energy producers, but prices are not high enough to dampen consumer spending. A key variable for the U.S. economy is manufacturing, which was improving in the spring but has recently ticked down.[3] Manufacturing improvements would go a long way toward accelerating economic activity.

We expect U.S. growth will advance modestly. Following a weak first quarter in which U.S. real GDP grew only 1.1%,[2] we think second quarter growth may have rebounded to close to 3%. We expect growth to average around 2% in the second half of the year, which would be consistent with the slow pace since the end of the Great Recession.

Key Index Performance

	TOTAL RETURN	
	2Q16	YTD
S&P 500 Index	2.5%	3.8%
Dow Jones Industrial Average	2.1%	4.3%
NASDAQ Composite	-0.2%	-2.7%
FTSE 100 Index (U.K.)	-1.8%	-4.0%
DAX Index (Germany)	-5.5%	-8.6%
Nikkei 225 Index (Japan)	1.4%	-3.4%
Hang Seng Index (Hong Kong)	2.4%	-2.6%
Shanghai Stock Exchange Composite Index (China)	-4.6%	-18.6%
MSCI World Index (ex U.S.)	-0.8%	-2.6%
MSCI Emerging Markets Index	0.8%	6.6%
Barclays U.S. Aggregate Bond Index (bonds)	2.2%	5.3%
BofA Merrill Lynch 3-Month Treasury Bill (cash)	0.1%	0.2%

Source: Morningstar Direct, Bloomberg and FactSet as of 6/30/16. 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.

1 Source: Bureau of Labor Statistics
2 Source: Commerce Department
3 Source: Federal Reserve

Volatile Markets Remain Close to Starting Points

The U.S. stock market has been quite volatile since the beginning of 2015, but you wouldn't know it just by looking at the S&P 500 Index, since prices are pretty much where they were six quarters ago.[4] Investors have digested mixed but generally positive economic news and continued weak earnings, while remaining focused on Fed policy and geopolitical risks. In this environment, the S&P 500 eked out modest gains, climbing 2.5% for the quarter and 3.8% so far this year.[4] From a style perspective, value is beginning to outperform growth, reversing a trend that dominated 2015. In the first half of the year, the Russell 1000® Value Index rose 6.3% while the Russell 1000® Growth Index climbed only 1.4%.[4] Smaller cap stocks have lagged larger cap, with the Russell 2000® Index increasing 2.2% year-to-date.[4]

Most markets outside the U.S. fared worse, with the MSCI World ex-U.S. Index down 2.6% halfway through 2016.[4] European markets were hard hit by Brexit and have endured uneven economic growth. Asian markets have performed unevenly, as corporate earnings have struggled and widespread monetary easing has caused volatility.

In contrast, bond markets have performed well in an uncertain environment. Interest rates moved unevenly lower through the first half of the year, then plummeted following the Brexit vote. The 10-year Treasury yield declined from 2.27% at the start of the year to 1.47% by the end of the second quarter (and subsequently fell further to record lows).[4] In this environment, the Barclays U.S. Aggregate Bond Index advanced 5.3% over the first six months of 2016.[4] Cash investments, meanwhile, increased only 0.2% due to extremely low short-term interest rates.[4]

There appears to be a disconnect between historically low bond yields and a slowly growing economy. In our view, downward pressure on bond yields has little to do with U.S. economic fundamentals. We believe it has more to do with investors around the world pouring money into safe haven assets due to political instability and economic uncertainty. At present, global forces are the main driver of U.S. rates, and risks are rising for a clash between international forces pushing yields lower and domestic signs of inflation boosting yields higher. May data show core inflation rose to an annual rate of 2.2%, the seventh consecutive month of an increase of 2% or more.[5] Given these crosscurrents, we don't expect a Fed rate hike until at least after the U.S. elections. And even then the Fed must have solid confidence that the U.S. economy is not suffering from overseas weakness.

Equity Sectors

	TOTAL RETURN 2Q16	YTD
Consumer Discretionary	-0.9%	0.7%
Consumer Staples	4.6%	10.5%
Energy	11.6%	16.1%
Financials	2.0%	-3.3%
Health Care	6.3%	0.4%
Industrials	1.4%	6.5%
Information Technology	-2.7%	-0.2%
Materials	3.7%	7.5%
Telecommunication Services	7.1%	24.9%
Utilities	6.8%	23.4%

Source: Morningstar Direct, Bloomberg and FactSet as of 6/30/16. Equity Sectors are classified using the Global Industry Classification Standards (GICS) based on the S&P 500. 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.

4 Source: Morningstar Direct, Bloomberg and FactSet as of 6/30/16

5 Source: Labor Department

2016

SCORECARD

Overall Scoring	
✓	Heading in the Right Direction
?	Too Early to Call
✗	Heading in the Wrong Direction

2016 Remains a Frustrating Year

In January, we described 2016 as a year that would likely frustrate both the bulls and the bears. At the halfway point, this is certainly true. Economic growth and stock prices remain uneven, and we forecasted that equity prices would be volatile but would end the year close to where they began. With six months to go, the predictions we made at the beginning of the year are mostly on track.

1	✓	**U.S. real GDP remains below 3% and nominal GDP below 5% for an unprecedented tenth year in a row**	At this point, getting this prediction correct seems like a slam dunk. The economy grew only 1.1% on a real basis in the first quarter.[5] Similar to the last couple of years, we expect a rebound after a weak start to the year, but growth is likely to remain modest. It is hard to imagine real growth exceeding 3% or nominal growth averaging over 5%.
2	?	**U.S. Treasury rates rise for a second year, but high yield spreads fall**	We will likely get this prediction half-correct. We think Treasury rates will rise from the current lows, but they may not advance for the year due to global economic weakness and negative global government bond yields. High yield spreads have narrowed from 660 basis points to 594,[6] and we believe credit sectors remain more attractive than government bonds.
3	✓	**S&P 500 earnings make limited headway as consumer spending advances are partially offset by oil, the dollar and wage rates**	Corporate earnings have been weak over the past year, but we expect a modest recovery over the coming quarters, especially as the drags from falling oil prices and a rapidly rising dollar are fading. As of now, consensus expectations for 2016 S&P 500 earnings-per-share are $117, which is close to the $118 level we saw in 2015.[7]
4	✓	**For the first time in almost 40 years, U.S. equities experience a single-digit percentage change for the second year in a row**	It's tough to make a case for a strong equity market in the next six months. But it's equally hard for us to see how prices could fall dramatically. We think the next six months will look a lot like the last six, as equity prices remain volatile but generally range-bound.
5	✗	**Stocks outperform bonds for the fifth consecutive year**	As of the end of the second quarter, stocks are trailing bonds (the S&P 500 Index is up 3.8% while the Barclays U.S. Aggregate Bond Index has risen 5.3%).[8] If we are correct, and the economy improves slightly, earnings are able to recover modestly and yields start to rise again, we think stocks will be ahead of bonds by year-end.

5 Source: Commerce Department
6 Source: Barclays. Spreads reflect the option-adjusted spread of the Barclays High Yield 2% Issuer Capped Index relative to Treasuries
7 Source: Bloomberg
8 Source: Morningstar Direct, Bloomberg and FactSet as of 6/30/16

EQUITIES SHOULD OUTPERFORM

"Equity markets face a number of crosscurrents, and it is tough to make a case for a significant move in either direction. Yet, we expect equities will beat bonds over the next six to twelve months."

6	?	**Non-U.S. equities outperform domestic equities, while non-U.S. fixed income outperforms domestic fixed income**	This is another prediction that is trending to be half-correct. U.S. stocks are outperforming non-U.S. equity markets, thanks in part to better economic growth and a stronger dollar. In contrast, non-U.S. fixed income has comfortably outperformed U.S. fixed income. The Barclays Global Aggregate Bond ex U.S. Index is up an impressive 11.9%, as global bond yields have fallen dramatically.[9]
7	✗	**Information technology, financials and telecommunication services outperform energy, materials and utilities**	This prediction is clearly heading in the wrong direction. Financials and information technology are the only two sectors with year-to-date negative performance. In contrast, energy and materials have rallied as oil prices advanced. Telecom and utilities are leading the way as investors seek yield and income. A basket of our favored sectors is currently up 7.1% while our least-favored are up 15.7%.[9]
8	✓	**Geopolitics, terrorism and cyberattacks continue to haunt investors but have little market impact**	The Brexit vote sparked near-term uncertainty, but we expect the global and U.S. economies should survive the fallout. Sadly, as the massacre in Orlando shows, terrorism has become increasingly common. Overall market effects, however, have been limited.
9	✓	**The federal budget deficit rises in dollars and as a percentage of GDP for the first time in seven years**	Federal spending is rising, and neither Republicans nor Democrats appear focused on budget control. The most recent projections forecast a $534 billion deficit for 2016, an increase of more than $100 billion from 2015. At the same time, the deficit's percentage of GDP will likely increase from 2.9% to 4.9% this year.[10]
10	?	**Republicans retain the House and the Senate and capture the White House**	Intense interest in the U.S. elections is likely to increase over the coming months. The polls are trending in the wrong direction for this prediction, but four months is an eternity in politics. If we've learned anything this year, it is to expect the unexpected.

Past performance is no guarantee of future results.

9 Source: Morningstar Direct, Bloomberg and FactSet as of 6/30/16
10 Source: Congressional Budget Office

SELECTIVITY WILL BE KEY

"With equity markets facing a tough path, security selection will remain critical."

Markets Remain Stuck in Neutral, Seeking a Catalyst

Equity markets hinge on one key variable: corporate earnings. If earnings do not improve, we can't see how equity prices will be able to advance. If earnings do improve, it should pave the way for better market performance. After more than a year of earnings contractions, we expect to see growth over the coming quarters. Earnings were down 5% in the first quarter, and appear likely to be flat or down fractionally in the second quarter.[11] If the economy grows slowly and oil prices remain stable, we think earnings will grow somewhere in the low single digits in the third quarter and in the mid single digits in the fourth. These are hardly stellar results, but it would be a step in the right direction.

Following the Brexit vote, the next issue appears to be uncertainty over the U.S. elections. Regardless of investor opinion about Hillary Clinton, the economic policies outlined by the Clinton campaign appear clear and transparent, and come with a measure of certainty. The same cannot be said about Donald Trump, as the views that have been outlined are inconsistent and lacking specificity (at least as of now, and he does have four months to amplify and clarify his proposals). Donald Trump's most clearly articulated views indicate the possibility of triggering trade wars, which would likely be negatives for the U.S. and global economies. From those perspectives, at least, we think equity markets would currently favor a Clinton victory.

In any case, we are unlikely to see a strong breakout in prices either to the positive or negative direction. We think the best equity investors can hope for is a similar environment to what has been in place over the last 18 months: lots of back-and-forth as equities slowly grind higher. But bonds and cash also offer limited upside. For long-term investors, prospective real and nominal returns are likely to be historically low and the risk/reward trade-off will be comparatively disappointing. In other words, the stock market is likely to lead this slow-moving parade.

Where does this leave investors? Equities are no longer as cheap as they once were. But we think valuations are reasonable, especially compared to bonds and cash. We expect the global economy to improve unevenly, which should help corporate earnings recover. If this occurs, equities should move unevenly higher. The pace of gains is likely to be slower than the first six years of this bull market. Within the equity market, we prefer mid-cycle cyclicals, companies that can generate positive free cash flow and those with higher levels of domestic earnings.

11 Source: FactSet

Key Themes for Investors

Matching Goals to Investments

As investors review their portfolios with their financial advisors, we offer the following themes as guideposts:

- **Maintain an overweight in equities, but be selective:** We think equity markets will continue to struggle, but should outperform bonds and cash over the coming six to twelve months. Gains will likely be narrower and more focused on specific sectors and companies, so selectivity will be crucial. We continue to focus on companies that can generate free cash flow and those with higher levels of domestically sourced earnings. We currently have a modest preference for large caps over small and value over momentum.
- **Equity market leadership may be shifting:** We expect the U.S. economy to accelerate modestly and remain biased toward companies that may benefit from an improving economy and rising bond yields. Additionally, the long-term trend of U.S. equity outperformance over non-U.S. equities may start to end, although the Brexit vote complicates this outlook.
- **Selectivity also matters in fixed income:** With low yields and the prospect of modestly rising rates, 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 credit sectors (including high yield) over government-related sectors makes sense, and we continue to have a favorable view toward municipal bonds.
- **Alternatives can play multiple portfolio roles:** Alternative assets, including real assets, real estate and other investments, can potentially provide a portfolio with diversified sources of risk, return and/or income. Alternative strategies such as equity long/short or market neutral could be worth considering since they have a low historical correlation to long-only, benchmark-oriented investments.

Characteristics we look for when evaluating companies:

- **Free cash flow** can provide flexibility to raise dividends, buy back shares and reinvest in the business
- 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

What Differentiates Nuveen?

Nuveen is guided by a deep commitment to securing the long-term goals of individual investors and the advisors who serve them. As part of TIAA Global Asset Management, Nuveen provides access to investment expertise from leading asset managers and solutions across traditional and alternative asset classes.

Investment Expertise From Leading Asset Managers

Our multi-boutique model builds on more than a century of industry leadership.

Alignment With Client Needs And Goals

Our capabilities address clients' specific and personalized financial goals.

Commitment To Advisors And Investors

We align outstanding people and relevant services with each client relationship.

Nuveen Asset Management delivers global multi-asset class solutions as one of Nuveen's seven independent affiliates.

Building upon its leadership in municipal bonds, Nuveen Asset Management manages $148.5 billion in assets* with diverse investment capabilities:

- Municipal and Taxable Fixed Income
- Fundamental Equities
- Real Assets, Asset Allocation and Non-Traditional Strategies

*As of 3/31/16.

For more information, please consult with your financial advisor and visit nuveen.com.

INDEX DEFINITIONS

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. 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. **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. The **Russell 1000® Value Index** measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The **Russell 1000® Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The **Russell 2000® Index** measures the performance approximately 2,000 small cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. **Barclays U.S. Corporate High Yield 2% Issuer Capped Index** tracks the performance of U.S. non-investment-grade bonds and limits each issuer to 2% of the index. **Barclays Global Aggregate Bond ex. U.S. Index** provides a broad-based measure of the global investment-grade fixed income market outside of the United States.

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