Diversification is our highest-conviction idea. Institutional investors need to broaden market exposure to more opportunities and risks to reach long-term objectives in today’s low-yield environment.
Diversification and selectivity will become ever more important in 2020 and beyond, especially as we think yields will remain low, returns will be tough to come by and volatility may rise. That means getting more exposure to more opportunities and more risks across asset classes, while remaining nimble.

Nuveen’s investment theme for this year is 20/20 vision: A clearer path for growth. The “clearer path” part is pretty straightforward: Our investment leaders think the macro fears that dominated most of 2019 have receded. Monetary policy is easier than it was a year ago, and global recession risks seem to have faded too. Trade policy remains a source of concern but hasn’t been causing the sorts of market sell-offs it did in late 2018 and earlier in 2019. And while other geopolitical events such as the 2020 U.S. elections, rising tensions in the Middle East and Brexit negotiations likely will spark fresh bouts of volatility, we think what has been the longest postwar economic expansion in history still has legs.

But it’s that “20/20 vision” part of our theme that we think may be more important. Because 2020 looks to be a year where investors will need keen vision to closely scrutinize markets to find the fewer investment opportunities that exist the longer the bull runs.

While we continue to find good investment opportunities across asset classes, we are also increasingly concerned about fuller valuations, whether the asset in question is a stock or a real estate asset. And although we’re calling for continued global growth, we recognize that the world is in the later stages of the current economic and credit cycle.

So, putting our 2020 theme in context, picture a year in which the economy’s path seems clearer but markets ... not so much. That’s a notable shift from what investors have come to expect over the past decade when we enjoyed strong financial returns while worrying about economic growth. The bottom line: Be prepared to tamp down your return expectations.

What should institutional investors do? Our asset class insights and investment ideas offer these investors different options to diversify portfolios in these low-yielding and return-challenged markets.
Asset class insights and investment ideas

Diversification is our highest-conviction idea. Institutional investors need to broaden market exposure to more opportunities and risks to reach long-term objectives in today's low-yield environment.

In our view, diversification is about much more than simply having a combination of assets with low correlations in a portfolio. It includes diversity of research, idea generation, time horizons, assets, sectors, themes, managers, styles, approaches, factors, views, geographies and investment policies.

Here are our best ideas for institutional investors to diversify their portfolios in 2020.

Private and public real assets

**BEST IDEAS:** On the private side, we are finding good opportunities in agricultural investments focused on sustainability and healthier diets. We are positive on toll roads in politically stable environments that have solid traffic patterns, such as in Australia and France. We also like regulated utilities, especially those with electricity transmission exposure that will continue to benefit from increasing investment demand.

**Opportunities and positioning**

- We think it makes sense to focus on more defensive areas of the real assets market. The broad macro backdrop continues to look somewhat challenging for both public and private real assets. Easier global monetary policy has been promoting additional liquidity, which has been a plus. But slow global growth means that downside risks remain relatively high. Geopolitical uncertainty (including in the Middle East, Hong Kong and Chile) has added to volatility.
- In public markets, defensive growth areas look more attractive than more cyclical sectors. REITs and listed infrastructure performed well in 2019 and have income and stability characteristics that should continue to appeal to investors. We have an especially favorable view toward the logistics and data center industries.
- Within public infrastructure, we like utilities and toll roads and prefer more highly regulated utility companies with no or low exposure to commodity prices.
- On the private real assets side, farmland and timberland asset values remain supported by low global interest rates. Issues such as trade volatility, the multi-year drought in Australia and the expansion of African Swine Flu in Asia require investors to approach these asset classes with careful selectivity, however.
- Although we continue to be constructive on agribusiness private equity generally, broad valuations appear rich with debt levels creeping higher. Discipline and sourcing remain critical.

**Risks to our outlook**

- Rising interest rates would work against defensive positioning in the public real asset space. Likewise, stronger-than-expected growth would boost the more cyclical areas of the market.
- Additionally, trade issues continue to represent risks across all real assets. We think ongoing uncertainty on this front will likely mean that market volatility will remain elevated.

*Portfolio context comments in real estate section on next page.*

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
Real estate

**BEST IDEAS:** A consistent theme is investing in a wide range of global cities that offer scale, growth, sustainability and resilience. In the U.S., we like niche and evolving sectors, such as life sciences and data centers. In Europe, we are focused on housing, student accommodation and logistics.

**Opportunities and positioning**

- Global economic and region-specific risks such as Brexit appear to have receded. At the same time, the two main risks for real estate markets (oversupply and excessive debt levels) do not appear present. This means we continue to see value in real estate markets, especially in terms of income generation.

- Pockets of the retail market are proving unloved by occupiers and investors alike, with changes in consumer patterns, e-commerce and technological advancements dramatically challenging how, where and when we consume. The office sector is adapting to the growing presence of flexible space operators and a more discerning tenant base; but overall demand and real estate performance has been challenged by economic headwinds and limited development.

- We continue to favor defensive growth areas that produce solid income. In particular, we like alternative real estate sectors such as medical technology locations (which benefit from a global aging population), data centers (which should benefit from the launch of 5G networks) and multi-family housing (as co-living trends are on the rise).

- Across all sectors, we are putting environmental sustainability at the forefront of our investment strategies and asset management initiatives.

- Commercial real estate debt in the U.S., U.K. and Australia continues to offer good risk-adjusted returns. Demand for funding is high in these markets but supply from traditional lenders (such as banks and insurers) remains constrained. CRE debt can provide diversified, stable income streams while delivering some downside protection.

**Risks to our outlook**

- Risks of an unexpected rise in interest rates has waned. But a material economic slowdown would hurt real estate.

- We are also focused on political risks associated with the U.S. elections that could result in additional rent or commercial property regulations. Regulatory changes in some European housing markets could also present risks.

**Portfolio context for real assets and real estate**

- Global real assets and real estate, particularly those not correlated to downstream commodities, are a good source of idiosyncratic risk, which helps embed more diversification into portfolios.

- Given our expectations on the business cycle, we think long-term rates have limited room to rise significantly from here. We like public real estate and real assets as a defensive growth alternative to market-cap-weighted indexed equity exposure that also provide a hedge against an upswing in inflation expectations from current low levels.

- Real assets can provide income for institutional portfolios. We prefer sourcing income in real assets as opposed to lower quality corporate debt.

- Liquidity remains a concern. Given that private market access is a key requirement for many sectors of the real estate and real asset markets, we recommend investors maintain their long-term strategic asset allocation split between public and private assets.
Emerging markets debt

**BEST IDEAS:** We continue to like local markets across several markets as well as dollar-denominated debt in both investment grade and select high yield countries. Some of these countries include Ukraine, Egypt and Brazil where we remain favorable on the reform agenda, and the likes of Indonesia and Peru, which offer macroeconomic policy stability. We also see opportunities in some of the less well-known markets, such as Uzbekistan, Jamaica, Angola and Bermuda.

**Opportunities and positioning**

- We remain constructive on emerging markets debt due to a supportive macro environment and relative valuations versus developed markets. Many aspects of emerging markets — hard currency sovereign and corporate credit, local currency bonds and foreign exchange — remain attractive relative to developed markets.

- We continue to expect further rate cuts in many economies where inflationary pressures remain benign or are falling, which will continue to support growth. Looser monetary policy at core central banks should continue to drive inflows and limited net new issuance in external debt markets should also continue to support the asset class. Being nimble and selective will remain key.

- The returns on local markets may be boosted more by currency than duration if we were to see the U.S. dollar moving sideways or weakening. We think the U.S. dollar may begin to get weighed down by rising valuations, stabilizing global growth, room for further Fed cuts and posturing by the U.S. government.

**Risks to our outlook**

- The trade war creates uncertainty and hurts global trade and manufacturing, which tends to be a large part of EM economic and market performance. Emerging markets will struggle to outperform if trade tensions escalate, but they will respond well amid signs of any improvement in relations between the U.S. and China.

- Emerging markets economies and issuers could come under pressure if we see substantial and sustained increase in U.S. treasuries or the U.S. dollar.

**Portfolio context**

- Emerging markets offer opportunities for investors seeking the longer-term value risk premium. An allocation to debt markets provides less volatile exposure to the value risk premium and to the EM growth premium relative to developed markets.

- With rates in developed markets expected to remain range-bound, we look to access U.S. rates duration and better-quality adjusted spread duration using hard currency EM debt as opposed to U.S. high yield bonds.

- Local EM debt lends itself well to security selection alpha and remains a good place to spend a portion of a portfolio’s active risk budget.
Private credit

BEST IDEAS: Lending strategies that are focused on a diversified set of industries in defensive sectors, such as health care, business services, software-related technology and industrials.

Opportunities and positioning

• The asset class continues to be a good match for long-term investors, especially those with long-term liabilities. It’s worth noting that while generally less liquid than publicly listed assets, private credit offers a premium for this illiquidity.

• When the next economic and broad market downturn inevitably arrives, we believe senior middle market loans could provide investors access to attractive yields from relatively conservative assets with inherent downside protection.

• We remain focused on defensive sectors, such as health care and technology, while avoiding lending to borrowers in industries reliant on commodities and heavy cyclicals. We think it is essential for investors to partner with top-tier private equity sponsors with decades of successful experience investing in the same industries.

• A secondary market for private credit fund interests is emerging due to the growth of private credit managers and the enormous interest in the private debt space over the past several years. Given the current income dynamic of these investments, we think this market could develop significantly over the next several years, offering opportunities for large institutional investors seeking to diversify their portfolios.

• Even at this late stage of the cycle, there is a case for an allocation to mezzanine debt in a private credit portfolio provided it meets our strict lending parameters. This can position the portfolio for value and yield opportunities in the coming phases of the cycle.

• We see more opportunities in the U.S. than in Europe. The maturity of the U.S. market allows direct-lending managers to be highly selective and hand pick the very best deals for their portfolios. In turn, investors have access to better market dynamics and more conservative assets.

Risks to our outlook

• In the current market, we have seen more aggressive structures typically found in the larger broadly syndicated loan market continue to creep into the upper middle private market, such as covenant-lite loans. Given the increased competition for middle market loans, we are also seeing credits being underwritten with weaker overall credit profiles. We believe these trends will continue until there is some sort of credit event that gives lenders pause.

• From an industry perspective, the increased importance of scale will drive smaller managers to larger, more diversified platforms. Merger and acquisition activity will continue to grow in private debt as the costs to compete for deal flow and support the required infrastructure will make it challenging for these smaller managers.

Portfolio context

• Broad allocations to alternative, less liquid assets should be maintained in accordance with a portfolio’s long-term investment objectives.

• Among a portfolio’s alternative exposure, capital currently reserved for, but not committed to, private equity is likely to be better rewarded on a risk-adjusted basis in private credit for 2020 vintages.

• While we continue to see select opportunities in mezzanine debt, in most cases we recommend that investors stay senior in the capital structure and increase their average credit quality given risk-adjusted spreads. Senior mid-market private credit should outperform more junior, subordinated paper over the coming quarters given an expected uptick in default rates.

• We like sourcing spread duration and security selection risk in private credit. The asset class provides clear access to manager skill as they leverage relationships in the origination process, improve credit selection through in-depth credit analysis and have room to negotiate favorable terms and bond structures.
Impact investing

BEST IDEAS: Our top three ideas are inclusive growth, affordable housing and resource efficiency, which span a range of asset classes and investment strategies.

Opportunities and positioning

• Broadly speaking, we see solid opportunities as investors are increasing their focus on finding investment solutions to social and environmental challenges together with attractive financial returns. The range of opportunities for institutional investors in terms of asset class, investment size and desired risk-return profile has increased over recent years.

• The inclusive growth theme is pursued via a private equity strategy that is global in nature and primarily targets emerging markets. The thesis is that low-income customers are paying customers and that those customers are underserved. We look at areas like financial services — credit, savings, insurance, remittance — and find companies that are exclusively targeting that low-income demographic. The products need to be designed differently. The approach to customer acquisition needs to be tailored. Healthcare and education also form subsectors of this strategy as well. We believe there are ample profitable and sustainable businesses that can have significant inclusive benefits.

• Another area of interest and focus is an affordable housing real estate strategy focused on preserving affordable housing stock in the U.S., keeping rents affordable for existing tenants and implementing energy retrofits to reduce costs and benefit the environment. The idea is to provide housing stability for working Americans.

• Resource efficiency is an additional private equity investment strategy that brings efficiency to value chains in multiple sectors, ranging from real estate and agriculture to manufacturing. It can either involve companies providing services to those value chains or disrupting the value chains themselves.

Risks to our outlook

• At a macro level, we recognize that many problems cannot be solved by impact investing alone. Governments, or other public sector stakeholders, need to want to address these issues too.

• A challenge, rather than a risk, is measurement. As an industry, we need to ensure that investment decisions are based on evidence and the investment activities are making the right impact. While many managers do this individually, we need to come together to establish measurement standards. This will underpin the credibility of impact investing.

Portfolio context

• A portfolio’s exposure to impact investing is a function of many wide-ranging factors. It could be defined in a trust’s investment objectives, driven by demand from beneficiaries, or a strategy set by an investment committee, to name just a few.

• As it seeks different objectives from the risk and return metrics offered by many traditional investments, impact investing is often considered an alternative asset class or strategy. At Nuveen, however, we can, and do, apply this approach across all asset classes, pursuing positive social and environmental impact alongside competitive financial returns.

• The wide variation of risk-return profiles across the asset class spectrum for impact investing means that institutional investors should be able to include it in portfolios whether they are seeking income, capital growth or other goals.

• This variety of risk-return options has advantages and disadvantages. It requires additional layers of due diligence, which involve a deep dive into the investment’s ability (and that of the investment manager) to deliver on the specific impact, the desired returns and the expected risks. But on the plus side, there are now many more options for institutional investors to improve outcomes in terms of impact and their portfolio’s risk and return characteristics.
Investing with Nuveen

Nuveen offers solutions for a range of institutional investors. We provide investors access to liquid and illiquid alternative strategies such as real estate, real assets (farmland, timber, infrastructure), private equity and debt, in addition to both traditional and fixed income assets.

Access to these strategies includes pooled funds, separate accounts and co-investment opportunities.

Our heritage as a pension fund means we understand the challenges other like-minded investors face. We have successfully been investing through market cycles for over 100 years, for both ourselves and our investment partners.

We work closely with our clients to understand their requirements and develop forward-thinking investment opportunities.

Short-lived market cycles, evolving investor needs and sustainability pressures bring with them significant opportunities and challenges. We focus on three investor objectives across all of our client solutions:

- Generating income and capital growth, despite the low-rate environment by focusing on demographic needs to grow assets and match liabilities.
- Managing risk in a world of ongoing uncertainty by focusing on structural trends to insulate against short-lived market cycles.
- Managing assets cost-effectively via optimal scale and access by leveraging our global scale to bring like-minded investors together.

For more information, please visit nuveen.com

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A word on risk

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 investing involves risk. Foreign investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as “high yield” or “junk” bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria excludes securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don’t use these criteria.

Nuveen provides investment advisory services through its investment specialists.

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