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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Rates and REITs: Can the real estate rally hold?

Bottom line up top

Will we remember the 18th day of September? Those betting on a September U.S. Federal Reserve rate cut had reason to cheer last Wednesday. Although the Fed remained on pause for its eighth consecutive meeting, its policy statement acknowledged both aspects of the central bank's dual mandate: price stability and maximum employment. The change in language signaled that the primacy of inflation-fighting over the past two years may finally start giving way to a greater emphasis on fostering economic growth. Fed Chair Jerome Powell said as much during his post-announcement press conference, noting a rate cut was possible "as soon as September." Powell also reaffirmed that the rate decision still depends on "the totality of the data, the evolving outlook and balance of risks."

The risk that data dependence may go — or has already gone — too far. A sharp selloff in U.S. equity markets the two days after the Fed's rate announcement may reflect investor worry that the Fed has fallen behind the curve. At the same time, last week brought another batch of data releases making a case for a September cut (and possibly more by year-end):

- The JOLTS (Job Openings and Labor Turnover Survey) report for June showed the number of available positions declined to 8.18 million, or 1.2 openings per seeker (a three-year low).
- Reflecting softer demand for labor, the Employment Cost Index (ECI), a measure of inflation in wages and employer-paid benefits, slowed to +0.9% in the second quarter (Figure 1), down from +1.2% in Q1 and well below its most recent peak of +1.4% in the first quarter of 2022.

Saira Malik, CFA
Head of Nuveen Equities and Fixed Income, Chief Investment Officer

On behalf of Nuveen's Global Investment Committee

As Head of Equities and Fixed Income, Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

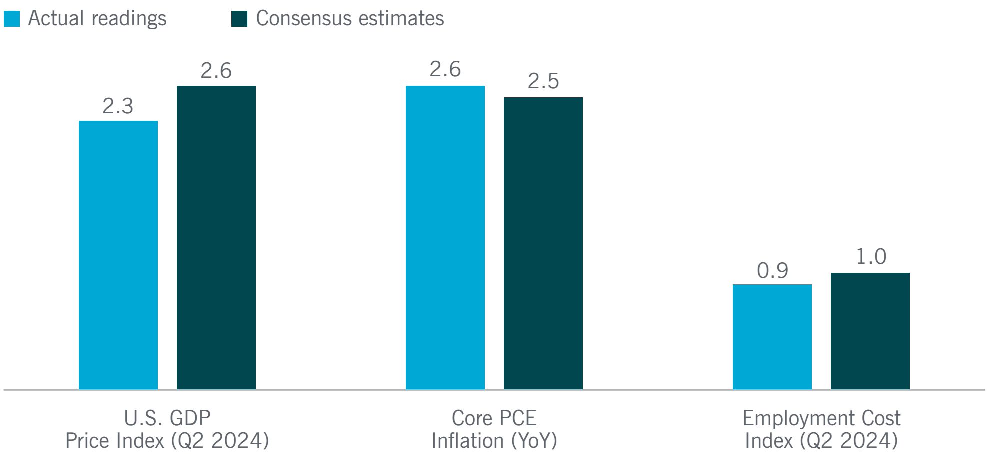
It’s looking almost certain that the Fed will finally cut rates at its September meeting.

- Friday’s nonfarm payrolls report for July confirmed the employment slowdown, with a tepid 114,000 new jobs created for the month — lower than the consensus estimates of 175,000 and last month’s downwardly revised 179,000. The unemployment rate moved higher to 4.3%, while wage inflation (+3.6% year-over-year) fell compared to June. All told, the weaker jobs data helped increase the market odds for multiple Fed rate cuts this year.

Investors seeking to take advantage of what increasingly looks like a lower-rate environment on the horizon have a number of options to consider, including a portfolio allocation to listed public real estate assets.

FIGURE 1: SLOWER U.S. INFLATION MAY FINALLY SWAY THE FED

Estimated vs. actual inflation data (%)



Data source: Bloomberg, L.P., 31 Jul 2024. Inflation measures: **U.S. GDP Price Index:** U.S. GDP Personal Consumption Core Price Index; **Core PCE Core Inflation (YoY):** U.S. Personal Consumption Expenditure Core Price Index YoY; **Employment Cost Index:** Bureau of Labor Statistics Employment Cost Civilian Workers (QoQ).

Portfolio considerations

Publicly listed U.S. real estate has endured a tough five-year stretch, absorbing the impact of the pandemic and then a Fed rate-hiking cycle that was unprecedented in its scope and speed. But with an improved outlook for inflation and expectations for the Fed to start cutting rates this fall, real estate was the best-performing sector in the S&P 500 Index for July, returning +7.2%. We believe the recent rally has room to run, as U.S. real estate investment trusts (REITs) are still trading at a 6% discount to their net asset value, as measured by the MSCI US REIT Index (Figure 2).

We expect real estate to enter a new a fundamental cycle over the next year or two, due to very little new supply having been built in the office, retail and senior housing property sectors since the pandemic. Even in an area like apartments, which has seen outsized supply over the past several years, we anticipate new inventory will fall off sharply in 2025, which bodes well for rent growth. Among the factors inhibiting expanded supply (and thus supporting higher rents) is a steep rise in construction costs, which have jumped 44% since 2020.

We think the recent sharp rally in real estate has further room to run.

Senior housing remains one of our favorite areas in the commercial real estate universe. These properties continue to claw back occupancy in their recovery from the pandemic, with operators now having recouped more than 85% of their Covid-era decline. Senior housing operators also benefit from high operating leverage, which means occupancy gains should ultimately result in robust net operating income growth over the next few years. Additionally, the aging population will continue to feed strong demand, while an overall lack of affordable housing should support the sector as well. We also believe rent growth will remain well above historical levels.

FIGURE 2: REAL ESTATE MAY OFFER COMPELLING VALUE

U.S. REITs premiums/discounts to NAV (%)

Data source: Bloomberg, L.P. as of 19 Jul 2024. Data depicts the historical premium and discount of the MSCI US REIT Index on an equal-weighted sector basis compared to the net asset value of the underlying properties. **Past performance does not predict or guarantee future results.**

About Nuveen's Global Investment Committee

Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.

Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

For more information, please visit nuveen.com.

Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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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 investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Real estate investments are subject to various risks associated with ownership of real estate-related assets, including fluctuations in property values, higher expenses or lower income than expected, potential environmental problems and liability, and risks related to leasing of properties.

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