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CIO Weekly Commentary
09 September 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A vote for munis amid rate cuts

Bottom line up top

Anti-inflation campaign winds down, race to avoid recession revs up. With at least one rate cut by the U.S. Federal Reserve this fall basically a foregone conclusion, financial markets have shifted their focus from bringing down inflation to shoring up economic growth. Market volatility has climbed amid downside surprises in macroeconomic data — especially labor market indicators — as we saw last week and during July. With the employment picture no longer resilient, the S&P 500 Index ended its three-week winning streak, falling more than 4% last week. Meanwhile, the bellwether 10-year U.S. Treasury yield ended the week down 19 basis points (bps), settling at 3.72%, its lowest level since June 2023. The recent investor unease reflects mounting concerns that the Fed's impending and long-awaited reversal in monetary policy may be too late to avoid a recession caused by the central bank's two-year tightening cycle.

Labored breathing a new symptom for formerly healthy labor market. Historically tight employment conditions (huge demand for workers and not enough supply) was the foundation of the U.S. economy's recovery from the depths of COVID lockdowns, but the resilience came with a notable side effect: strong wage growth that fed into untenably high levels of inflation. The Labor Department revised its monthly nonfarm payrolls total downward by a shockingly large -818,000 jobs for the 12-month period ended 31 March 2024. This massive revision lowered the job creation run rate to +180,000 per month for the period. Even though this number was largely in line with longer-term averages, the magnitude of the revision cast a pall on what was already a gloomier employment outlook.

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

On behalf of Nuveen's Global Investment Committee

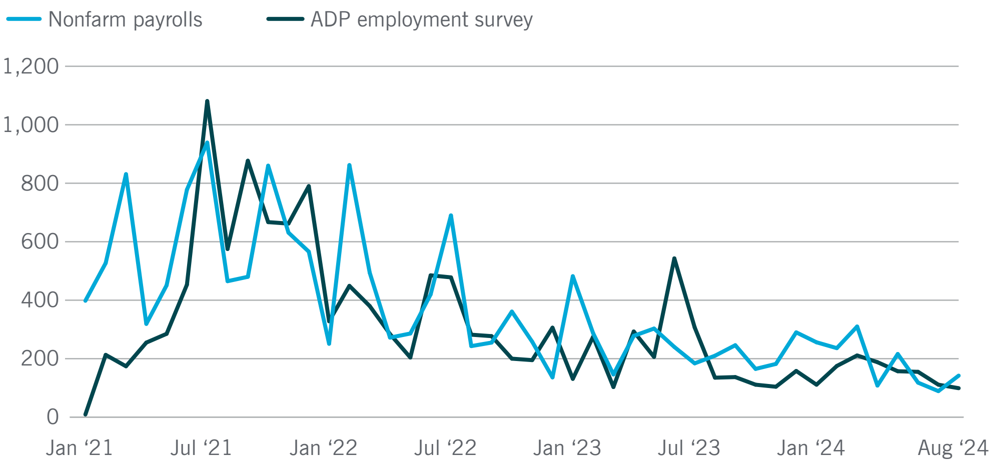
As Head of Equities and Fixed Income, Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas.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

Investor attention (and the Fed's) is shifting from inflation to economic growth concerns.

The August data for private payrolls from ADP and monthly nonfarm payrolls from the Bureau of Labor Statistics (Figure 1) showed weaker-than-expected jobs growth. Considered alongside plummeting JOLTS (Job Openings and Labor Turnover Survey) data for July, the latest payrolls data points to a likely reversal in a nearly three-year trend of labor market strength. Should this prove true, the Fed may cut rates more aggressively this month (for example, by 50 bps instead of 25).

FIGURE 1: THE U.S. LABOR MARKET IS SHOWING SIGNS OF STRESS

Monthly reported jobs growth (thousands)



Data source: FactSet, 6 Sep 2024.

Portfolio considerations

Municipal bonds are having a strong year and remain one of our favorite asset classes in the current market environment. We're particularly constructive on **high yield municipals**, which have returned +6.5% year-to-date through August, as measured by the Bloomberg High Yield Municipal TR Index. With a taxable-equivalent yield of 8.9% (for those in the top income tax bracket), high yield munis offer an attractive source of income. We see three other potential drivers of compelling muni performance in the near-to-medium term:

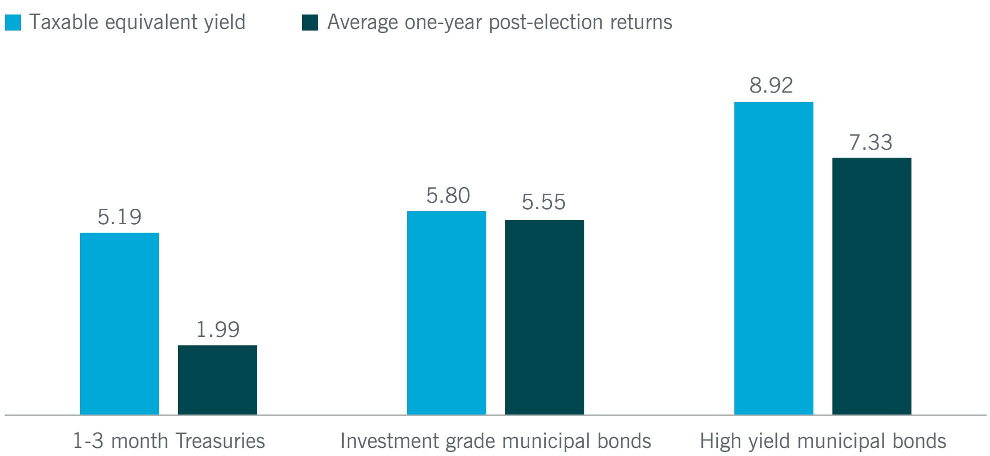
The electoral calendar: The municipal asset class has historically performed well after U.S. Election Day. Figure 2 shows the average return for both investment grade and high yield munis for the one-year post-election period over the past seven election cycles.

Fed rate cuts: We anticipate a total of 75 bps worth of cuts between now and year-end — with more to come in 2025. Investors with large cash allocations have the opportunity to rotate into fixed income sectors to lock in attractive starting yields, if they haven't already done so. Cash yields are poised to decline as the Fed lowers its policy rate. Meanwhile, the municipal yield curve is positively sloping, and investors are being rewarded for extending duration. High yield munis generally have longer durations than their investment grade counterparts, allowing investors to take advantage of higher yields further out on the curve. During the most recent rate-cutting cycle (2019), investment grade and high yield municipals returned +3.3% and +5.6%, respectively, in the six months following the first cut.

Sound fundamentals: The current municipal landscape is built on a solid foundation. About 75% of the high yield municipal bond index, for example, is made up of higher-quality (BB rated) issues. Default rates for these BB rated municipals are roughly equal to those of investment grade (BBB rated) corporate bonds. This attractive fundamental backdrop is complemented by favorable supply and demand factors: According to Lipper, flows into high yield municipal bond funds totaled $9.9 billion year-to-date through August. That amount represents more than 50% of all municipal fund flows in 2024, exceeding the typical 15% to 20% amount. On the supply side, we expect municipal issuance to slow from its current pace. We believe new issues will remain oversubscribed, reflecting continued robust demand.

We think the electoral calendar, rates environment and fundamental backdrop could all be favorable for municipal bonds.

FIGURE 2: MUNICIPAL BONDS OFFER COMPELLING YIELDS AND HAVE HISTORICALLY PERFORMED WELL FOLLOWING ELECTIONS



Data source: Bloomberg, L.P. Taxable equivalent yield data is as of 28 Aug 2024, based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary. Average one-year post-election returns data is from 1996 to 2020. **Past performance does not predict or guarantee future results. Representative indexes: 1-3 month Treasuries:** Bloomberg U.S. Treasury Bills: 1-3 Months; **Investment grade municipals:** Bloomberg Municipal Bond TR Index; **High yield municipals:** Bloomberg High Yield Municipal TR Index.

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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