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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Election reconsideration, a Fed recalibration and credit diversification

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On behalf of Nuveen's Global Investment Committee

As 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.

Bottom line up top

President Biden's exit from the U.S. presidential race adds to political volatility. Yesterday's news adds even more uncertainty around what has already been a tumultuous 2024 geopolitical landscape. Mr. Biden announced he will endorse Vice President Kamala Harris, but the exact path forward is uncertain. If this news gives former President Trump a bump in the polls, that could provide a further boost to areas of the market that have been pricing in increased prospects for a Republican sweep in November, such as the financial and energy sectors. If the reverse happens, it could be a plus for more globally-focused areas. In any case, we expect increased near-term volatility this heightened political uncertainty. One thing does seem certain: More twists and turns in the political roller coaster in the months ahead.

Hot summer, cool data. Last week's wave of softer-than-expected economic data, following the prior week's release of below-forecast CPI inflation for June increase prospects for a U.S. Federal Reserve rate cut. Last week's economic highlights:

- While retail sales were flat in June, they were stronger than anticipated and beat consensus estimates for a -0.3% decrease amid signs of slowing in the U.S. economy. Our takeaway: While consumers still appear resilient, their spending has started to moderate, consistent with a trending deceleration in real disposable income growth.

- On the housing front, building permits for new single-family units fell -2.3% in June. The continuing drop in this forward-looking metric points to potential weakness in housing starts.
- First-time unemployment claims jumped to a higher-than-expected 243,000. Continuing claims also surprised to the upside at 1.87 million, the highest level since November 2021.

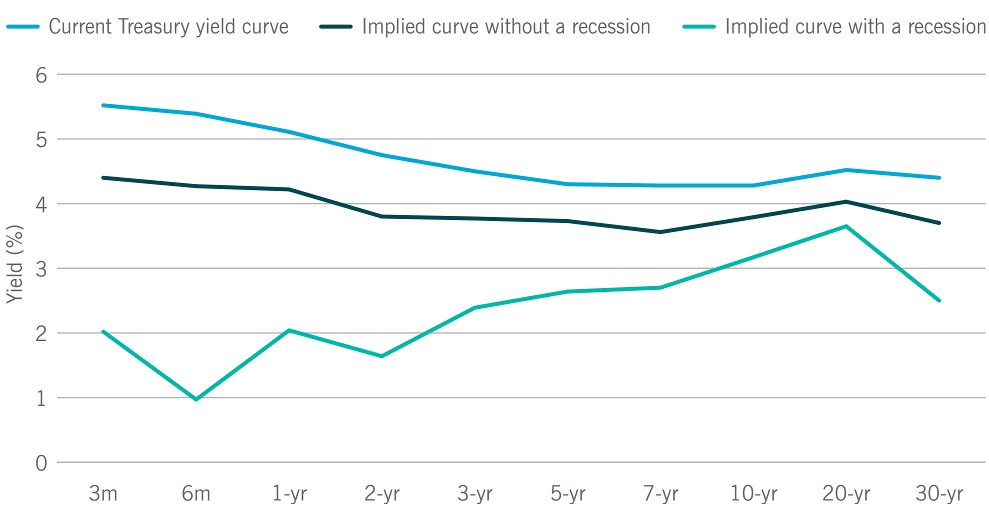
Fed watch and Fedspeak. Moderating economic data was accompanied by public remarks from a number of Federal Reserve Board governors. On balance, they conveyed that the Fed is "getting closer" to the point where a rate cut is warranted. Meanwhile, the Fed's "Beige Book" for July supported this assessment, with economic activity slowing, the labor market loosening and inflation trending lower.

With this combination of more dovish rhetoric and cooler data, markets are now pricing in a 100% chance of a rate cut at the Fed's September meeting. Figure 1 shows how the Treasury yield curve shifted during previous rate-cut cycles and whether those moves were associated with a recessionary or expansionary environment. This historical perspective offers a starting point for discussing the merits of increasing diversified credit exposure in portfolios.

Cooler economic data and easing inflation pressures suggest the Fed is inching closer to an interest rate cut.

FIGURE 1: A POSSIBLE RECESSION COULD DETERMINE THE SHAPE OF THE YIELD CURVE

Shifts in yield curves during previous rate-cutting cycles



Data source: Bloomberg, L.P., 30 Nov 1966 to 30 Jun 2024 (reflecting the history of the previous 11 rate cutting cycles). **Performance data shown represents past performance and does not predict or guarantee future results.** The implied curves depict the current U.S. Treasury yield curve minus the average historical shifts as a percent change in yields that occurred during these rate-cut cycles depending on whether a recession occurred or not. Rate cut cycles included: Nov 1966 to Jul 1967 (no recession); May 1968 to Dec 1971 (recession); Jun 1974 to Jan 1976 (recession); Mar 1980 to Dec 1982 (recession); Oct 1984 to Aug 1986 (no recession); Jun 1989 to Sep 1992 (recession); Jul 1995 to Jan 1996 (no recession); Sep 1998 to Nov 1998 (no recession); Jan 2001 to Jun 2003 (recession); Sep 2007 to Dec 2008 (recession); Jul 2019 to Mar 2020 (recession).

Portfolio considerations

With increased expectations for a sooner-rather-than-later start to the Fed's rate-cutting cycle, now looks like an especially opportune time to consider extending portfolio duration by shifting some assets out of short-term bonds and cash, while also complementing those allocations with exposure to diversified credit. Doing so could help investors diminish reinvestment risk, increase income potential and provide a cushion against rate volatility. And with real yields (i.e., nominal yields minus taxes and inflation) on cash equivalents such as six-month CDs currently near 0% (Figure 2), investors can find sectors that offer far more compelling real yields and total return potential than cash if U.S. Treasury yields decline from here, as we forecast.

With cash offering a close-to-zero real yield, we think investors should consider extending duration and finding value in select fixed income markets.

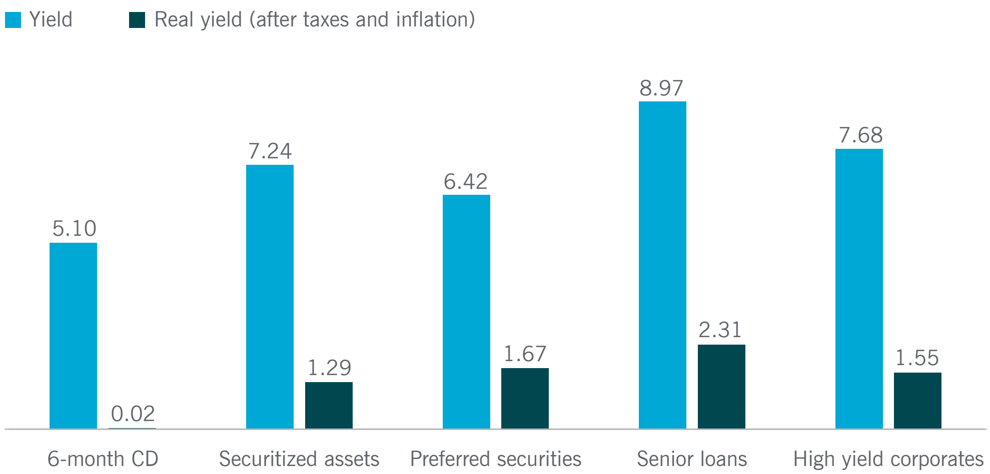
Investment grade that makes the grade. Among investment grade opportunities, securitized assets and preferred securities stand out. The securitized sector is not only attractively valued, but it's also one of the few areas of the market where spreads (the yield over Treasuries) are wider than their historical average, providing a favorable entry point. Within asset-backed securities (ABS), consumer and commercial credit performance continues to stabilize. As for commercial mortgage-backed securities (CMBS), we see substantial reward potential for investors willing to accept the risks and challenges facing office and retail properties. Lastly, preferred securities are underpinned by fundamental strength in U.S. banks (the largest issuers), all of which recently passed The Fed's 2024 "stress tests." We especially favor $1,000 par preferreds, which currently offer yields of 6.59% and a duration of 3.55 years (a higher level of income per unit of duration compared to $25 par securities).

Below investment grade that's a cut above. Senior loans and high yield corporate bonds continue to impress. Senior loans remain one of the highest-yielding asset classes across global fixed income markets. Loan fundamentals remain sound, with refinancings at a robust pace and borrowers still pushing out their maturity walls. Demand is particularly strong thanks to the ongoing formation of collateralized loan obligations (CLOs), the largest purchaser of senior loans. We expect healthy demand to persist, supporting elevated income and solid total return potential.

High yield corporates have benefited from resilience in the U.S. economy and also feature healthy fundamentals. We expect default rates to rise amid some signs of decelerating economic activity, but only to levels near their long-term average, as credit quality for the overall asset class has improved notably in recent years. We like noncyclical sectors and higher-quality issuers with strong balance sheets, but we're also finding attractive total return opportunities among good companies in beaten-down sectors. Active credit risk management and selectivity are key as the economy slows and securities become mispriced.

FIGURE 2: CD YIELDS AREN'T AS ATTRACTIVE AS THEY APPEAR

Nominal and real yields (%)



Data source: Bloomberg, L.P., 15 Jul 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 6-month CD:** Marcus by Goldman Sachs 6-month CD rate; **securitized assets:** Equal blend of ICE BofA AA-BBB US Fixed Rate CMBS Index, ICE BofA US Fixed Rate ABS Index and Bloomberg US MBS Total Return Index; **Preferred securities:** ICE BofA U.S. All Capital Securities Index; **Senior loans:** Credit Suisse Leverage Loan Total Return Index; **high yield corporates:** Bloomberg U.S. Corporate High Yield Total Return Index. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.** After-tax yields are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Preferred data assumes 80% of the income is QDI-eligible and taxed at the 20% QDI rate plus 3.8% Medicare surtax rate. The rest of the preferred income is taxed at the federal income tax rate of 37% and 3.8% Medicare surtax rate. Individual tax rates may vary. Inflation is based on U.S. CPI Urban Consumers YoY rate of 3.0%, as of 30 June 2024.

Areas of the securitzied assets, preferred securities, senior loans and high yield markets look compelling.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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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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