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CIO Weekly Commentary
03 February 2025

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A nascent real estate recovery beckons

Bottom line up top

Topsy-turvy week keeps the markets guessing. Last week's deluge of data, market-moving headlines and high-profile corporate earnings releases provided a volatile backdrop for the one big calendar item that wasn't a surprise: the U.S. Federal Reserve's decision to pause its rate-cutting cycle.

A manic Monday kicks things off. Investors weren't prepared for the sudden surfacing of Chinese tech startup DeepSeek and the revelation that its new artificial intelligence (AI) models might rival those of the established industry leaders at a fraction of the cost. This news sent the tech-heavy Nasdaq Composite Index tumbling more than 3% and the S&P 500 Index down 1.5%, led by its information technology sector (-5.6%), on Monday. This was likely an overreaction — we think innovations from DeepSeek and other smaller players will ultimately be a positive that enables broad efficiencies and lower AI costs across the industry. Meanwhile, four of the Magnificent Seven mega cap tech names reported their quarterly earnings last week, with mixed but generally respectable results.

It's not only about tech. The housing market got a boost as sales of new single-family homes increased +3.6% in December, to a 698,000 seasonally adjusted annual rate. And new home inventory was up +10% compared to a year earlier. This represents an 8.5 months' supply at the current building pace (Figure 1). The upbeat tone in housing wasn't matched by the latest consumer confidence data, with The Conference Board's index falling to 104.1 in January, its lowest level in

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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.

four months. This dip reflected some pessimism about the labor market, inflation and the trajectory of interest rates. The Fed echoed concerns about sticky inflation, leaving the fed funds rate unchanged at its meeting last Wednesday. While the pace of consumer price increases has slowed dramatically from its post-pandemic peak of 9%, inflation is still rising faster than the Fed's 2% annual target.

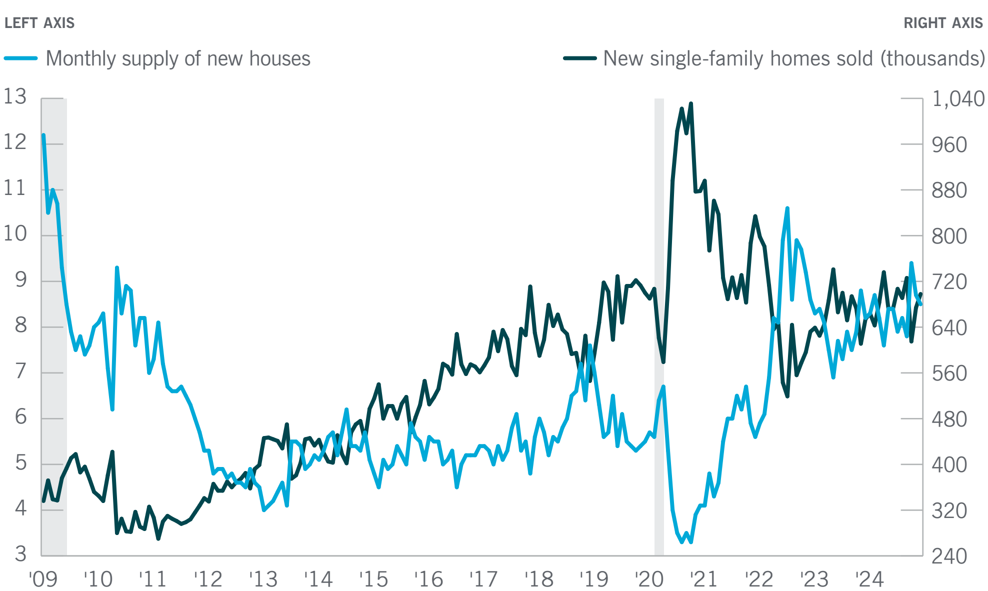
Despite the DeepSeek-sparked selloff on Monday, we think new entrants to the AI space are a positive for the industry.

GDP growth and inflation data cap off the cacophony. The busy week closed with two key pieces of data: the advance estimate of fourth-quarter U.S. GDP growth, which came in at +2.3%, and the Personal Consumption Expenditures (PCE) Price Index, which increased +0.3% for the month of December and + 2.6% year over year. Core PCE, which excludes volatile food and energy costs and is the Fed's preferred inflation barometer, rose +0.2% on a monthly basis and +2.8% compared to a year ago. The numbers suggest the Fed will remain focused on inflation pressures.

Investors are now contending with economic and market conditions that have only become more complex, with unanswered questions about the potential impact of major policy shifts under the Trump administration and the likelihood that interest rates will remain higher for significantly longer than initially expected. That said, we still see attractive asset class opportunities to consider in this unsettled environment.

FIGURE 1: U.S. HOUSING SUPPLY CONTINUES TO EXPAND

New housing supply compared to new single-family houses sold



Data source: Federal Reserve Bank of Saint Louis, Jan 2009 to Dec 2024. Shaded areas represent recessions.

Still-sticky inflation will likely translate into ongoing upward pressure on interest rates.

Portfolio considerations

A green shoot in commercial real estate. For much of the past two years, real estate was challenged by upward pressure on capitalization rates (net operating income divided by market value) and discount rates (the current value of future cash flows). Both metrics suffered as construction increased in markets where demand was softening, leading to higher vacancies and slower rent growth. Recently, these headwinds have broadly abated as real estate markets across the world recorded positive total returns in the most recent readings available (Figure 2).

On track for a cyclical trend? History suggests that commercial real estate may be at a potential inflection point. Market participants who invested at the bottom of the prior three economic cycles (the early 1990s recession, the 2000 dot.com bust and the Global Financial Crisis) realized strong gains over the subsequent five years. On a compound annual growth basis, the returns for the three cycles ranged from +12.0% to +14.6%, according to the U.S. NCREIF Open End Diversified Core Equity Index, a measure of 25 open-end private real estate funds. A similar rebound for the asset class is possible (though not guaranteed) in today's market.

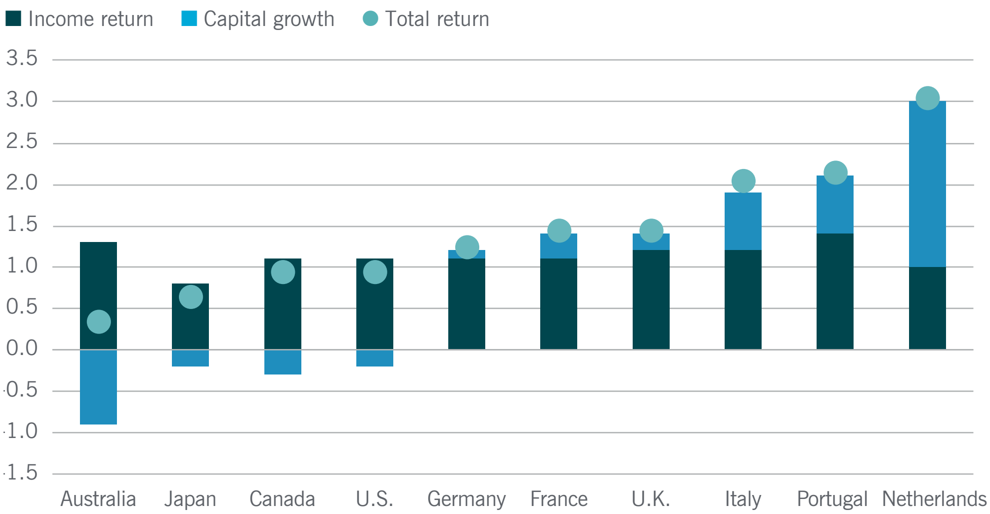
Real estate opportunities abound. Given varied demographic patterns and other distinctions across countries and regions, we think a global perspective is valuable when investing in real estate. It's been about a decade since U.S. **apartment** and **industrial** building starts were as subdued as they are today. Additionally, construction levels in both the **office** and **retail** property sectors are at historical lows. These conditions set up the respective sectors for occupancy recovery and rent growth. Within the U.S., **medical office** stands out, as occupancy levels are at all-time highs, new supply is muted and the country's aging demographics are fueling increased demand. In both the U.S. and Japan, aging populations, along with limited new supply, are creating attractive investment opportunities in **senior housing.** Europe, in contrast, is experiencing a "golden era" of youthfulness, driving demand for **student housing.** Amid relatively more welcoming immigration policies, the number of international students and English-taught courses is growing, helping to boost the rankings of universities on the continent.

Data centers remain compelling on a global scale. The rise of artificial intelligence (AI) and other data-reliant technology has kicked off an unprecedented rise in data usage. The global "datasphere" is projected to reach a massive 181 zettabytes in 2025, nearly 12 times the size it was just 10 years earlier, according to International Data Corporation, a global technology research firm. (One zettabyte equals approximately a trillion gigabytes.) Supply growth is increasing, but power constraints across geographic regions are likely to prevent it from catching up to demand soon. For example, although data center supply growth has picked up in Europe, vacancy rates have fallen by 2%, and rents continue to climb. In North America, data center vacancy rates hit a record low of 2.8% in 2024, as major tenants continued to expand their footprint.

The headwinds for real estate that have held markets back for the last two years are finally fading.

FIGURE 2: REAL ESTATE RETURNS WERE POSITIVE ACROSS THE GLOBE

3Q 2024 returns in select countries (%)



Data source: Country returns from the MSCI Global Quarterly Property Index (Q3 2024 returns as of Dec data release, most current available). **Performance data shown represents past performance and does not predict or guarantee future results**.

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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

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Endnotes

Sources

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

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