

## CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

# A bumper crop of portfolio potential

## Bottom line up top

**Investors may have plenty to be thankful for.** Thanksgiving week is here in the U.S., which for some means it's time to rewatch a certain 1987 comedy classic about two strangers trying to make it home for the holidays via planes, trains and automobiles. This year — inevitable travel headaches aside — investors are enjoying a season of warmer earnings, cooler inflation and the growing likelihood that the U.S. Federal Reserve has reached the end of its rate hike cycle. Since the Fed held rates steady at its November meeting, the S&P 500 Index has gained a little over 7%, while the 10-Year U.S. Treasury yield has fallen from a cycle peak of nearly 5% to approximately 4.5%. Shifting interest rate expectations and lower-than-consensus Consumer and Producer Price Index readings for October have allowed investors to focus on corporate earnings, which have turned positive after three consecutive quarters of negative growth. The limited number of economic data releases remaining in 2023 are unlikely to stymie recent market momentum, and we believe this still-young Santa Claus rally can persist through year-end. That said, 2024 will bring its own challenges, calling for a fresh look at portfolio positioning.

**Still on the menu: healthy portions of assets offering economic resilience and inflation protection.** Portfolios are sure to be stuffed with increased equity allocations this holiday season, but investors should be mindful of extended valuations and other risks aplenty for the economy and capital markets. Notably, with inflation remaining more than a percentage point above the Fed's stated 2% target, the question of "How high will the central bank's policy rate go?" is transitioning to "How long will it stay elevated?" While markets are currently pricing



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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.

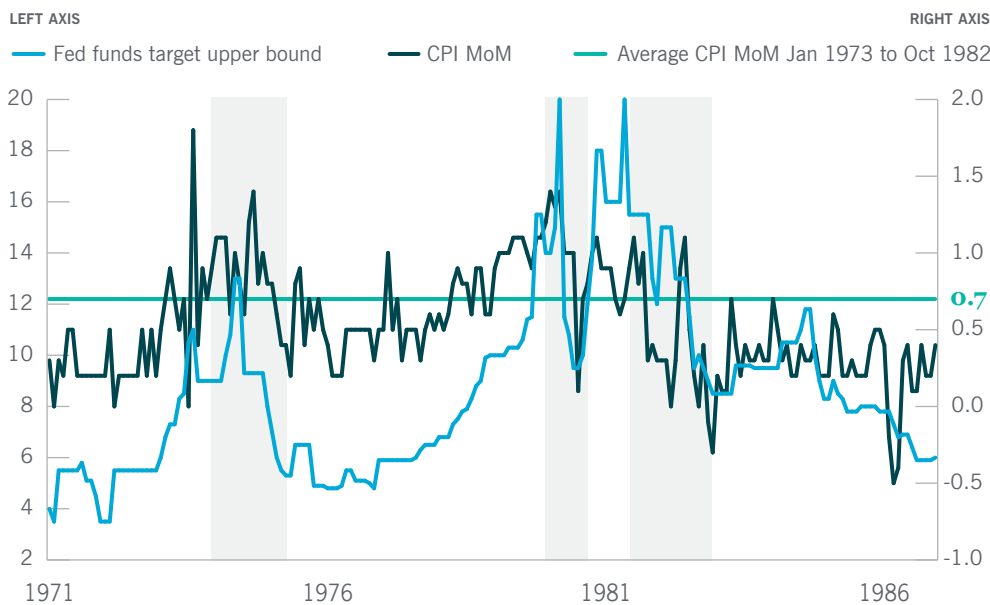
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in three to four rate cuts in 2024, they should remember that Fed Chair Jerome Powell is committed to avoiding past monetary policy mistakes – namely, premature interest rate cuts like those that led to 9% annualized inflation and three separate recessions during the nine-year period from 1973 to 1982 (Figure 1). Instead of relying too heavily on traditional equities and fixed income based on overly optimistic rate-cut outlooks, we suggest diversifying with an asset class that not only helps shield against higher rates and a potential recession, but is also the source of many a Thanksgiving meal: farmland.

**FIGURE 1: FED INFLATION FIGHTING IN THE 1970s AND 1980s**

*Federal funds target rate vs. inflation (%)*



Data source: Bloomberg L.P., 29 Jan 1971 to 31 Oct 2023. Performance data shown represents past performance and does not predict or guarantee future results. Shaded periods of recession as defined by the NBER (monthly): Nov 1973 to Mar 1975; Jan 1980 to Jul 1980; July 1981 to Nov 1982.

## Portfolio considerations

**Over the river and through the woods to consistency we go.**

Historically an effective hedge against inflation, real assets appear well-suited to the current macro backdrop. Farmland looks particularly compelling because it provides basic necessities, and demand for the goods it produces should be resilient in a weakening economic environment. We analyzed annual returns for farmland going back to 1970 and found that since then it has produced a positive result for every recessionary year except 2009. In fact, farmland’s average return during recessionary years in this time frame was +12.6%, nearly double the 6.6% inflation rate and higher than the S&P 500’s gain by more than 4.5 percentage points. Farmland has outpaced inflation by close to 6% in non-recession years as well.

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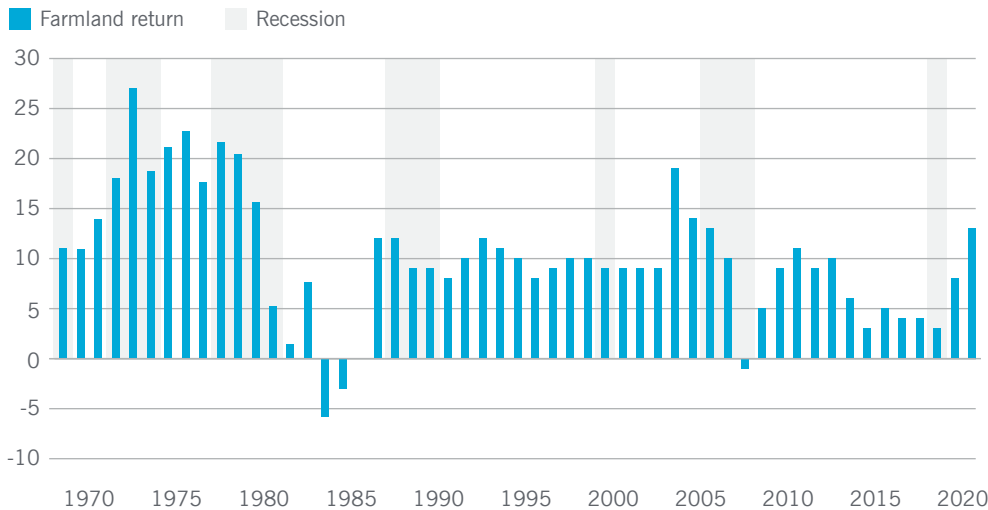
Volatility of returns for farmland since 1970 has been significantly lower than that for U.S. equities, with a standard deviation of 6.5, compared to 17.2 for the S&P 500. An allocation to farmland may therefore improve a portfolio's Sharpe ratio (a measure of risk-adjusted return), offering downside protection amid an anticipated economic slowdown in 2024.

**Fertile fields without mountains of debt.** From a balance sheet perspective, rising and elevated interest rates make it more expensive for farmers to purchase assets using debt. But higher borrowing rates typically occur when inflation is high (usually linked to increased prices on commodities like natural gas, wheat or steel), as we have seen since March 2022. Because farmland produces necessary agricultural commodities, it may fare better than other real assets during inflationary periods, enabling farmers to pay down debt and increase equity in their businesses. And if land is on their balance sheets, it will likely appreciate if the profitability of crops grown on that land increases. Farmers tend to be conservative when it comes to leverage, which has helped cushion them from asset bubbles and subsequent deflation. Despite volatile interest rates, the debt-to-equity ratio for farmers has remained relatively stable since the late 1980s, averaging 15.7% between 1990 and 2023, according to the USDA.

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**FIGURE 2: FARMLAND HAS HELD UP DURING PRIOR RECESSIONS**

*Farmland returns (%)*



Data source: TIAA center for Farmland Research at the University of Illinois, 1970-2020. Performance data shown represents past performance and does not predict or guarantee future results. Representative index: farmland return: U.S. Ag 32 State Index. Shaded periods of recession as defined by the NBER (annual).

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- 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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