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CIO Weekly Commentary
12 August 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Equity sector spotlights amid the fog of volatility

Bottom line up top

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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.

Volatility has its day in the dog days of summer. Last Monday saw global stocks plummet and bond yields struggle to find direction. The highlight (or lowlight) was the -12.4% drop in Japan's Nikkei 225 Index, its largest decline since 1987, followed by the Dow Jones Industrial Average falling more than 1,000 points. A combination of factors drove the selloff, including rapidly changing Japanese and U.S. monetary policy outlooks, a stronger-than-expected appreciation of the yen versus the dollar and concerns about a sharp deceleration of the U.S. economy. The drawdown came on the heels of market weakness from the week before and reflected intensifying concerns that the U.S. Federal Reserve had fallen behind the curve on rate cuts and wouldn't be able to "stick" a soft landing. Following Monday's tumult, markets stabilized for most of the rest of the week, although we expect volatility to remain relatively elevated.

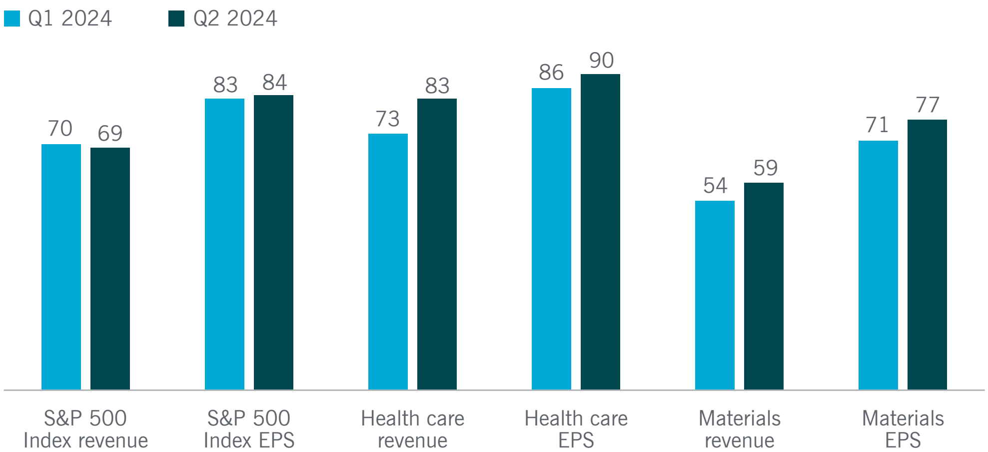
Fears of an economic crisis appear overstated. Fortunately, last week also brought evidence of U.S. economic resilience. The ISM (Institute for Supply Management) reading on the service sector rebounded from 48.8 in June to 51.4 in July, led by the new orders and employment subindexes (above 50 indicates expansion.) This ISM index has now expanded 47 times in the past 50 months — an especially compelling trend since services make up about 85% of U.S. GDP. And though the services economy has felt some stress from higher interest rates and weaker consumer spending, it remains a robust driver of overall growth. Lastly, the Atlanta Fed's GDP tracking estimate of +2.9% third-quarter GDP growth (as of 6 August) also suggests it may be premature to adopt a crisis mindset for the economy.

Notwithstanding last week's sharp equity declines, we see compelling opportunities in areas of the stock market.

Equity market challenges also present opportunities. While volatility and risks to the economy aren't going away any time soon, we see pockets of opportunity. On balance, we generally prefer U.S. over non-U.S. equities for their better defensive characteristics in case of an economic slowdown. Within the U.S., health care and materials look intriguing based on continuing improvement in the percentage of companies that have met or beaten revenue and/or earnings per share (EPS) expectations (Figure 1).

FIGURE 1: EARNINGS RESULTS FOR THE HEALTH CARE AND MATERIALS SECTORS ARE IMPROVING

Companies meeting or exceeding revenue and EPS expectations (%)



Data source: Bloomberg, L.P., 5 Aug 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Health care** and **materials** sectors reflect GICS sectors within the **S&P 500 Index**.

Portfolio considerations

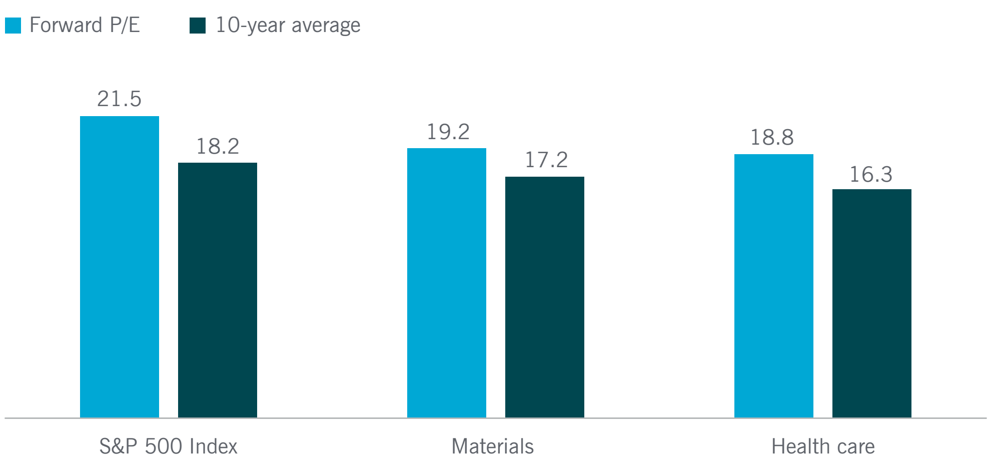
Despite the recent pullback, U.S. equities remain relatively expensive compared to historical averages. The forward price-to-earnings (P/E) ratio of the S&P 500, for example, is 19% higher than its historical average (Figure 2). P/Es for materials and health care, while also above their respective long-term averages, are lower compared to the overall S&P 500. And because both sectors have seen improved quarter-over-quarter earnings, we believe they offer better value and have solid upside potential — especially amid the volatility being driven by economic slowing, geopolitical tensions and uncertainty around the upcoming U.S. election.

Material advantages. Within materials, the chemicals industry continues to enjoy volume growth. Second-quarter earnings season has highlighted strong demand for chemicals in the U.S. and, to a lesser degree, certain European markets. Guidance from several chemical companies has turned more positive after striking a bearish tone in the previous earnings season. Additionally, consumer staples volumes are rising, and supplier outlooks are becoming more favorable. New construction activity, which is key to the materials sector, is also vibrant, belying the narrative of slowing trends in the broader economy. Although the pace of construction is expected to ease from recent levels, homebuilders continue to offer mortgage rate buydowns and other incentives to keep demand firm.

A healthy health care sector. The health care sector is outperforming the overall S&P 500 for the third quarter to date, in large part because of an outstanding earnings season. In the medical technology (medtech) space, we favor higher-quality, sustainable growers in the face of a potentially broader risk-off environment. Medtech continues to benefit from burgeoning demand for elective procedures that had been delayed by the pandemic. As for managed care, company balance sheets are flush with cash, and earnings season highlighted better operating earnings. Utilization is likely peaking, but we expect strong results to continue for hospitals. We're also keeping a close watch on the medical tools category for its long-term potential. Slow biotech funding has been a headwind for these companies, lasting longer than anticipated, but Q2 earnings results indicated the beginning of a recovery in certain end markets.

Both the materials and health care sectors offer relatively attractive valuations and are enjoying solid earnings growth.

FIGURE 2: HEALTH CARE AND MATERIALS SECTOR VALUATIONS LOOK COMPELLING



Data source: Bloomberg, L.P., 31 Jul 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: materials:** S&P 500 Materials Sector Total Return Index; **health care:** S&P Health Care Sector Total Return 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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