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CIO Weekly Commentary
11 November 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Positioning for tax cuts, tariffs and deregulation

Bottom line up top

Big wins after needles and pins. Investor reaction to last week's decisive U.S. election showed how emphatically market participants can celebrate the end of uncertainty. Expectations of a tight race and concerns about a delay in declaring a winner failed to materialize. Instead, by the end of last week post-election buoyancy had lifted the S&P 500 Index to its 50th record-high close of the year.

Last week brought another vote as well, but this result was a foregone conclusion: Members of the U.S. Federal Reserve's policymaking committee unanimously chose to lower the fed funds rate by 25 basis points (bps), to a target range of 4.50%-4.75%. It was the second Fed rate cut in as many meetings, although only half the size of the 50 bps reduction announced in September. We continue to expect another 25 bps cut at the next meeting in December, even though market expectations for future cuts have tempered lately (Figure 1).

From campaigning to governing. With the election over, we can shift our focus to what a Republican-led administration and Congress might mean for the global economy, financial markets — and asset allocation. In the U.S., we anticipate an economic agenda focused on lower taxes, higher tariffs and deregulation. Specifically, we could see a temporary extension of the 2017 Tax Cuts and Jobs Act, a rollback in the top income tax bracket and higher limits on state and local tax deductions. While tax cuts aim to promote growth, reduced federal tax receipts may lead to higher fiscal deficits. Additionally, increased tariffs on imported goods, especially from major trading partners like China and Mexico, are not only likely to exacerbate global trade tensions, but also raise the possibility of reaccelerating U.S. inflation, leading to elevated bond yields.

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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.

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Such expectations have already contributed to a substantial backup in Treasury yields from their lows following the Fed's initial rate cut in September through the end of last week. The 2-year yield rose +65 bps, to 4.26% during this period, and the 10-year climbed +61 bps, to 4.31%. In his post-meeting press conference last week, Fed Chair Jerome Powell stated that the election results would not affect monetary policy, but that the Fed will respond as needed to changes in fiscal policy, but only once those fiscal changes are clear. Against this complex backdrop, investors may want to consider allocating to fixed income assets that have the potential to perform well if the incoming administration's tax, tariff and other fiscal priorities leave the Fed with less room for rate cuts in 2025.

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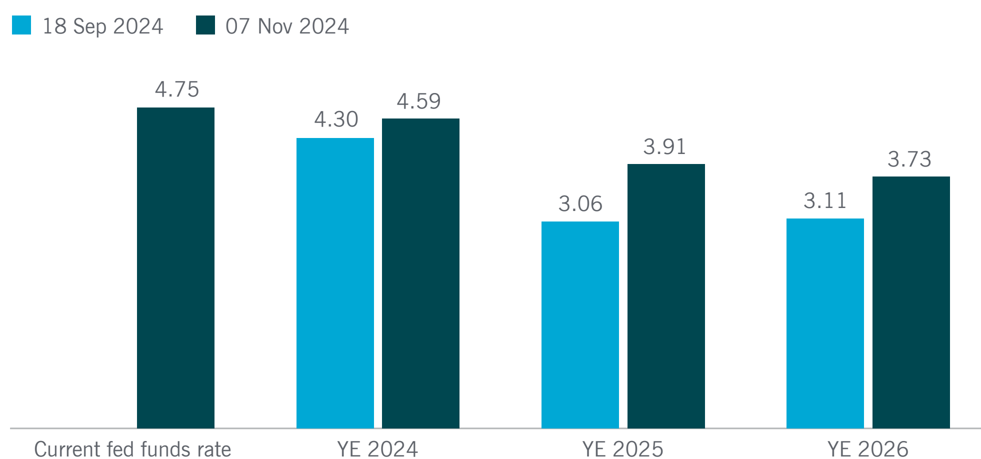
FIGURE 1: RATE CUT EXPECTATIONS HAVE RECENTLY DECLINED

Market expectations for the fed funds rate (%)



Data source: Bloomberg, L.P., 07 Nov 2024.

Portfolio considerations

Senior loans remain the highest-yielding liquid fixed income asset class at 8.7% (Figure 2), yet investor portfolios tend to be structurally underweight loans. In our view, a strategic allocation to senior loans can be an effective way to increase a portfolio's risk-adjusted return potential — a function of the diversification benefits senior loans offer thanks to their floating-rate coupon structure compared to longer-duration traditional fixed income.

With the incoming administration expected to focus on U.S. fiscal policies designed to promote economic growth, we anticipate both short-term and overall rates will remain elevated. This should provide a tailwind that enables senior loans to continue delivering high levels of current income while helping insulate investors from interest rate risk.

Within the loan asset class, we believe favorable market technicals could

support secondary price levels, while mergers and acquisition activity may bolster new issue opportunities to deploy cash at attractive yields. Net new issue volumes year-to-date have almost doubled from 2023 levels, with further significant growth possible in 2025.

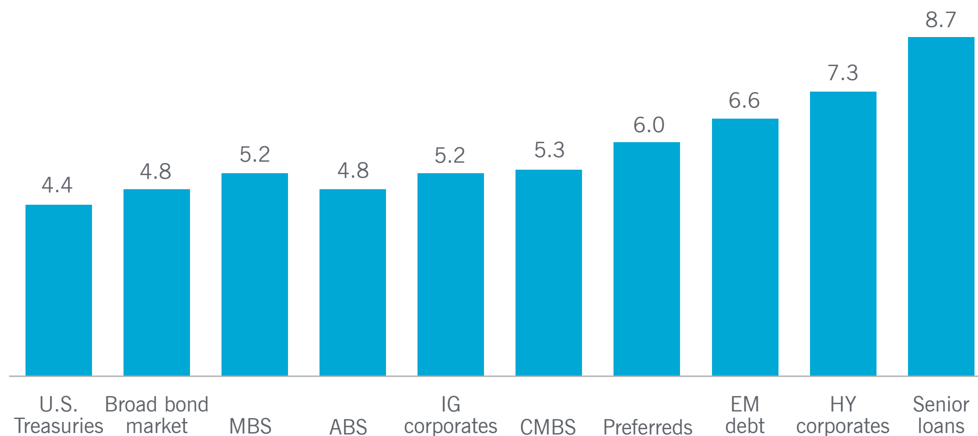
Given their floating-rate nature, senior loans have a low correlation to the Bloomberg U.S. Aggregate Bond Index — just 0.15 over the past 10 years. Meanwhile, their first lien position in a corporate capital structure has produced lower volatility per unit of return, resulting in the highest risk-adjusted return among all other fixed income investment categories, based on Morningstar data.

That said, senior loans are a below investment grade asset class that is best suited to active management and a focus on limiting downside risks. While we expect default rates to remain relatively low in light of the anticipated tailwind from pro-growth policies, active management can help position for potential winners and losers among loan issuers, as specific new policies and potentially higher-for-longer interest rates can have varying effects on different sectors and industries.

It's critical to maintain a liquid portfolio to position for potential winners and losers among loan issuers.

FIGURE 2: SENIOR LOANS ARE THE HIGHEST YIELDING PUBLIC FIXED INCOME SECTOR

Fixed income yields (%)



Data source: Bloomberg, L.P., 07 Nov 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: broad bond market**: Bloomberg U.S. Aggregate Index; **U.S. Treasuries**: Bloomberg U.S. Treasury Index; **MBS**: Bloomberg U.S. Mortgage-Backed Securities Index; **ABS**: Bloomberg Asset-Backed Securities Index; **IG corporates**: Bloomberg U.S. Corporate Investment Grade Index; **CMBS**: Bloomberg Commercial Mortgage-Backed Securities Index; **preferreds**: ICE BofA U.S. All Capital Securities Index; **EM debt**: Bloomberg Emerging Market USD Aggregate Index; **HY corporates**: Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index; **senior loans**: Credit Suisse Leveraged Loan Index. It is not possible to invest directly in an 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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Important information on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. A focus on dividend-paying securities presents the risks of greater exposure to certain economic sectors. Dividend yield is one component of performance and should not be the only consideration for investment.

Equity investments are subject to market risk, active management risk, and growth stock risk; dividends are not guaranteed. Non-U.S. investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. The use of derivatives involves additional risk and transaction costs. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, tax risk, political and economic risk, and income risk. As interest rates rise, bond prices fall. Credit risk refers to an issuer's ability to make interest payments when due. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Non-U.S. investments involve risks such as currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks are magnified in emerging markets. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Below investment grade or high yield debt securities are subject to heightened credit risk, liquidity risk and potential for default. The issuer of a debt security may be able to repay principal prior to the security's maturity, known as prepayment (call) risk, because of an improvement in its credit quality or falling interest rates. In this event, this principal may have to be reinvested in securities with lower interest rates than the original securities, reducing the potential for income. Senior loans may not be fully secured by collateral, generally do not trade on exchanges, and are typically issued by unrated or below-investment grade companies, and therefore are subject to greater liquidity and credit risk.

Nuveen, LLC provides investment services through its investment specialists.

This information does not constitute investment research as defined under MiFID.

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