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CIO Weekly Commentary

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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Nation allocation: picking spots for non-U.S. stocks

Bottom line up top

Uncle Sam's prognosis perks up. On balance, last week's U.S. economic data releases reassured investors who'd become convinced since late July that slower growth was deteriorating into imminent recession. Markets had made the leap from worst-case scenario to foregone conclusion as U.S. Federal Reserve policymakers appeared to fall further behind the curve on rate cuts.

But last week's benign data provided a counterpoint to the choruses of "too little, too late." Among the highlights:

- The headline Consumer Price Index (CPI) came in at 0.2% for July, up from 0.1% in June but in line with consensus forecasts. Headline CPI moderated to 2.9% year-over-year — a touch below June's 3.0% reading and market expectations, and the lowest print since March 2021. Core CPI, which excludes volatile food and energy prices, also rose 0.2% in July. Core CPI dipped from 3.3% year-over-year in June to 3.2% in July.
- Wholesale prices as represented by the Producer Price Index (PPI) increased 0.1% in July and 2.2% year-over-year, in both cases less than expected. Notably, the cost of services saw the largest decline in 17 months amid signs that businesses were losing pricing power.
- Retail sales blew past forecasts in July, rising 1.0% for the month versus the 0.3% consensus. The report shows that Americans remain confident spending as inflation moderates.

Saira Malik, CFA

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.

We've grown more comfortable reducing our U.S. overweight and shifting some assets into both developed and emerging non-U.S. markets.

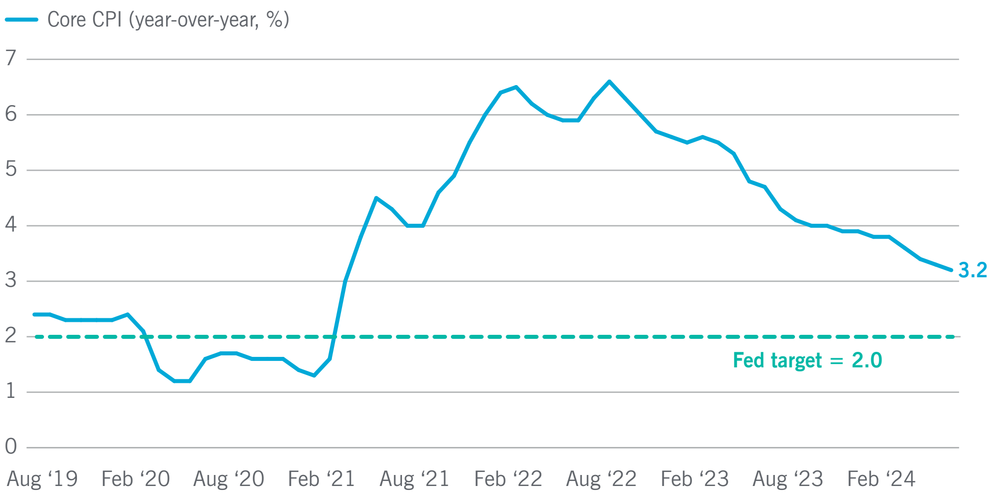
- Lastly, the release of first-time unemployment claims for the latest week came in at 227,000, below projections of 235,000 and down from the prior week's 234,000.

A September rate cut remains on track. Interest rates are still elevated, job creation is slowing and inflation remains sticky, but last week's economic news suggests that the economy is not in immediate danger. At the same time, the strength of these reports may have bolstered the case for a 25 basis points (bps) rate reduction instead of the 50 bps markets had begun to price in when recession fears intensified in late July.

Our most recent global equity market outlook still reflects an overall preference for U.S. over non-U.S. equities because of their better defensive characteristics in the face of potential economic headwinds. But we've also grown more comfortable with reducing our U.S. overweight and shifting some assets into both developed and emerging non-U.S. markets.

FIGURE 1: FALLING CORE CPI HAS INVESTORS OPTIMISTIC ON RATE CUTS

Core CPI (YoY, %)



Data source: Bloomberg, L.P., 31 Jul 2024. Core CPI represents the U.S. CPI Urban Consumers Less Food & Energy YoY.

Portfolio considerations

Non-U.S. equities from both developed and emerging markets (EM) remain underallocated in many portfolios, which means investors may be missing out on compelling opportunities to diversify and capture value.

- Compared to their U.S. counterparts, non-U.S. equities appear attractively valued based on their forward price/earnings (P/E) ratios.
- Analysts estimate that EM equities should deliver earnings-per-share (EPS) growth of 18.9% and 15.7% in 2024 and 2025, respectively (Figure 2).

Non-U.S. developed markets have been more challenged due to disappointing growth in Europe, but we see select opportunities in countries like Japan.

- With U.S. rate cuts on the near-term horizon, the prospect of a weaker dollar should be a tailwind for EM equities.

> ***China is the largest EM country, but its equity market continues to face headwinds, including mixed economic data.***

FIGURE 2: NON-U.S. EQUITIES OFFER ATTRACTIVE OPPORTUNITIES

Forward expectation measures for equity markets (%)

Data source: Bloomberg, L.P., FactSet, 09 Aug 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: emerging markets:** MSCI Emerging Markets Index; **Developed non-U.S. markets:** MSCI EAFE Index; **U.S.:** S&P 500 Index.

In the EM sphere, **Brazil** is among our most favored markets. Its economy has remained resilient, recent GDP prints have come in higher than expected, and Purchasing Managers' Indexes (PMIs) for both manufacturing and services are well into expansion territory. Unemployment continues to trend downward and is now at its lowest level since 2015. Lastly, the forward P/E for Brazilian equities looks inexpensive at 7.8x, well below its 20-year average of 10.1x.

Indonesia also shows noteworthy upside potential. Indonesian stocks have stayed under the radar, despite the country's favorable fiscal policy path. Indonesia is one of 11 EM countries with a fiscal deficit below 3% of GDP, while the U.S. fiscal deficit of 6.3% outpaces all but two EMs. Indonesia can also claim robust GDP growth (currently +5.1%) and tame inflation (+2.1%).

As for the elephant in the room, **China** is the largest EM country, but its equity market continues to face headwinds like mixed economic data, opaque governance and only limited policy support from Beijing in the form of smaller, targeted fiscal stimulus. Although recent strength in exports and manufacturing offers optimism, fears of deflation persist, with annual inflation at a mere +0.5%. And despite indications that the slump in China's residential property sector's slump may finally be bottoming, home prices remain stuck in the doldrums. China has encouraged state-owned enterprises (SOEs) to buy back shares and increase dividends to help boost returns, but this type of influence can overshadow fundamentals and make it more difficult to evaluate the Chinese stock market.

In terms of developed markets outside the U.S., **Japan** has endured a volatile few weeks, starting when the Nikkei 225 Composite Index plummeted -12.7% on 05 August. Given the recent sharp appreciation in the yen, which makes Japanese goods more expensive in other markets, export companies such as automobile manufacturers are bearing much of the pain. In contrast, companies that rely on domestic demand are less affected by the global market tumult. We continue to like Japanese domestic growth stocks. Banks are targeting 9% return on equity and buying back shares. And high-dividend stocks like construction companies should be relatively unscathed by the strong currency moves, as they're generally not exposed to large overseas projects.

We continue to like Japanese domestic growth stocks, which are less affected than export-oriented companies by the recent global market turmult.

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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