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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A home for real estate in multi-asset portfolios

Bottom line up top

The Fed commits to higher for longer. The policy implications of last week's U.S. Federal Reserve meeting injected a fresh dose of volatility into markets. Equity markets in particular took a tumble, with the S&P 500 Index falling 2.9% for the week. Fed Chair Jerome Powell's hawkish messaging overshadowed the widely anticipated decision to keep rates steady. Likewise, the Fed's "dot plot" of expected future rate levels implied one additional increase in 2023, after which rates will likely remain at their higher-for-longer plateau. These projections also included fewer rate cuts in 2024 compared to the Fed's previous dot plot in June — a shift that sent the Fed-sensitive 2-year U.S. Treasury yield to its highest closing level since 2006.

Seeking shelter from the hawks. With the Fed dominating headlines, several housing-related data releases fell under the markets' radar. Together they signaled a notable cooling-off of the U.S. housing market: New home construction fell over 11% in August (Figure 1), reaching its lowest level since June 2020, driven in large part by a 26% drop in multi-unit housing starts. At the same time, apartment rent increases decelerated, with Zillow's year-over-year rent index showing just 3.25% growth, down from nearly 8% at the start of 2023. With demand waning and real-time rent growth moderating, we expect further decreases in owners' equivalent rents, a component of the Consumer Price Index that currently accounts for 65% of the CPI's year-over-year increase and is reported on an approximately 12-month

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On behalf of Nuveen's Global Investment Committee

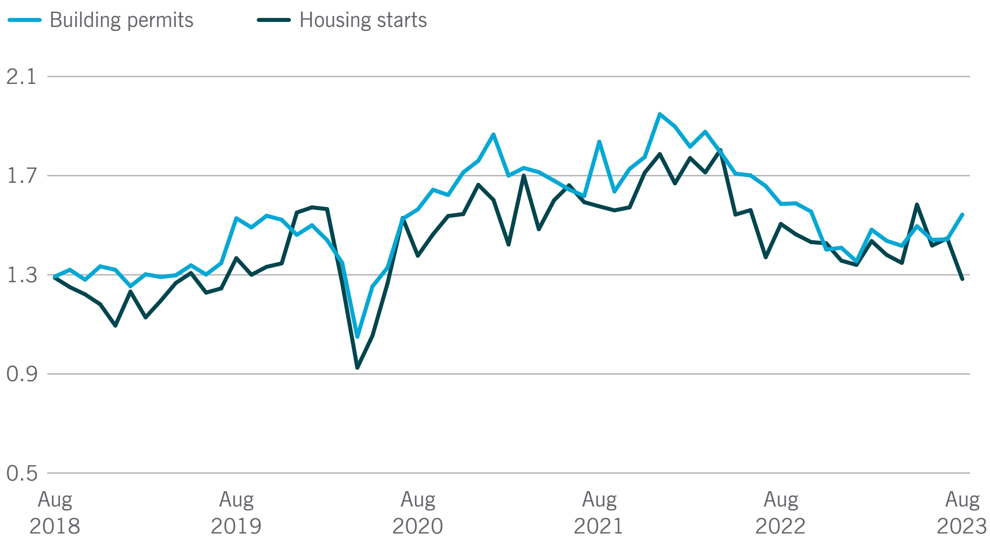
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

lag. If these expectations come to pass, we may see a definitive end to the Fed's current rate-hiking cycle — which could prove extremely beneficial for commercial real estate investments.

Last week's comments from the Fed seem to confirm that rate cuts are not coming any time soon.

FIGURE 1: A SOFTENING HOUSING MARKET COULD COOL INFLATION

U.S. housing starts and building permits (millions)



Data source: Bloomberg, L.P. as of 31 Aug, 2023.

Portfolio considerations

In our view, an allocation to real estate remains essential in a multi-asset portfolio. But choosing between public and private real estate exposure comes down to the specific role the allocation is intended to play. Publicly traded real estate investment trusts (REITs) have historically outperformed when equity markets are rallying, but also tend to exhibit higher relative volatility compared to the S&P 500 Index. Additionally, a REIT's share price may trade at significant premiums or discount to its net asset value (NAV). For example, publicly listed REITs currently trade at a -13% discount to NAV, versus their long-term average discount of -1% (Figure 2). Moreover, while REITs have historically lagged broader equity markets during central bank rate-hiking cycles, they have also shown relative outperformance as visibility to the end of the cycles improved (as was the case in 2006 and 2018). Such periods typically coincide with a broader economic slowdown when REITs' longer-duration cash flows find more favor in the market.

Private real estate offers the potential for attractive yields while offering diversification and uncorrelated returns during times of market turmoil, such as we saw during the Covid-induced recession and equity bear market. In contrast to public real estate, which is traded on stock exchanges where prices fluctuate daily, private real estate values are determined solely by observed, actual real estate transactions. As a result, private real estate typically experiences less volatility than its public counterpart, and tends to be less correlated to public equities.

The industrial sector appears to be bright spots in both public and private real estate.

We're currently finding attractive investment opportunities in both public and private commercial real estate. The gaming sector, a relatively new public REITs category, offers above-average cash flows and dividend growth. Since 2019, this sector has generated high-single-digit rental and dividend growth, reflecting annual rent escalations on most leases. Consolidation within the gaming industry has also been a tailwind, with external growth driven by sale leaseback agreements with operators. The sector has also benefited from limited new supply given regulatory restrictions on the number of casino licenses and the significant capital requirements to build.

We're also constructive on the industrial real estate sector in both public and private real estate. The sector is still being buoyed by e-commerce tailwinds, which should support urban logistics locations in growing metro areas of the South and West Coast. Additionally, supply chain diversification and nearshoring trends should boost demand for space at East Coast ports and U.S./Mexico border markets.

FIGURE 2: REAL ESTATE MAY OFFER COMPELLING VALUE

U.S. REITs premiums/discounts to NAV (%)

Data source: Bloomberg, L.P. as of 30 Jun, 2023. Data depicts the historical premium and discount of the MSCI US REIT Index on an equal-weighted sector basis compared to the net asset value of the underlying properties, as calculated by Green Street Research and S&P Capital IQ. **Past performance does not predict or guarantee future results.**

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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