CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Fed tees up fixed income for Jackson Hole-in-one potential

Bottom line up top

From "beat up" to "upbeat." Following their dramatic midsummer pullback, financial markets continued to regain their footing last week. The S&P 500 Index notched its first back-to-back positive weeks since the middle of July, reclaiming the 5,600 mark. Non-U.S. equity markets also gained. In fixed income, the bellwether 10-year U.S. Treasury yield fell 8 basis points to 3.1%. Some surprisingly strong consumer-oriented corporate earnings announcements and dovish minutes from the U.S. Federal Reserve's July meeting helped bolster investor optimism. The week was capped off by Fed Chair Jerome Powell's remarks at the central bank's annual Jackson Hole summit, where he expressed confidence in inflation's steady progress toward the central bank's 2% target, pointedly stating that "the time has come for policy to adjust."

More turbulence may lie ahead, keep your seatbelts fastened. While the recent market rebound has prompted a sigh of relief, this summer's volatility serves as a reminder to investors that there's no vacation from diligently monitoring portfolio allocations. As data releases continue to highlight the long-discussed deceleration in economic activity, forecasts calling for either hard or soft landings are bound to intensify. Notably, last week we saw a sizable downward revision (-818,000) to the U.S. Labor Department's nonfarm payrolls tally for the 12 months ended 31 March 2024. That correction — the second-largest negative restatement of job creation on record — made big headlines but not big waves in the markets. Investors appeared to shrug off the report, as it

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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.

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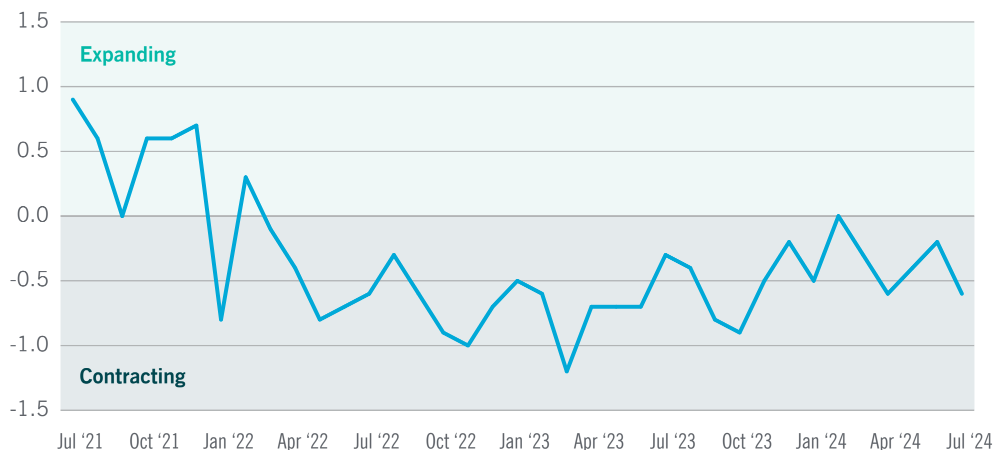
supported the narrative of a softening but still-sturdy labor market that the Fed hopes will clear the runway for a soft landing.

But defining 'soft' in this context may be hard. July's reading of The Conference Board's Leading Economic Index (LEI), seen as a predictor of major inflection points in the U.S. economic cycle, remained firmly in contractionary territory (Figure 1). The Conference Board pointed out that while the U.S. economy is expected to expand in the second half of 2024, headwinds to accelerated growth are mounting.

The current environment suggests that investors could consider allocating to areas of the market that appear poised for success in a falling rate environment, with the ability to outperform should recessionary conditions emerge.

FIGURE 1: LEADING INDICATORS SUGGEST A SLOWING ECONOMY

Leading economic indicators, month over month



Data source: Bloomberg, L.P., 31 Jul 2024. **Representative index:** Conference Board Leading Economic Indicator. Over 0 represents an expansion over the month, below 0 represents a contraction in economic growth.

Portfolio considerations

With a few weeks to go before the Fed likely makes its first interest rate cut of the cycle, there's still time for investors to add duration and credit exposure to their portfolios if they haven't already done so.

Treasury yields at the shorter end of the curve are poised to decline in response to rate cuts, while longer-maturity yields should come down given a modest slowdown in economic growth — a favorable backdrop for price appreciation in bonds. Even as the economy decelerates, consumer balance sheets remain solid, and business investment durable. We believe this combination could help keep corporate default rates low.

Additionally, the U.S. presidential election is just over two months away.

Over the past seven election cycles and across credit sectors, average one-year returns post-election have been strong (Figure 2).

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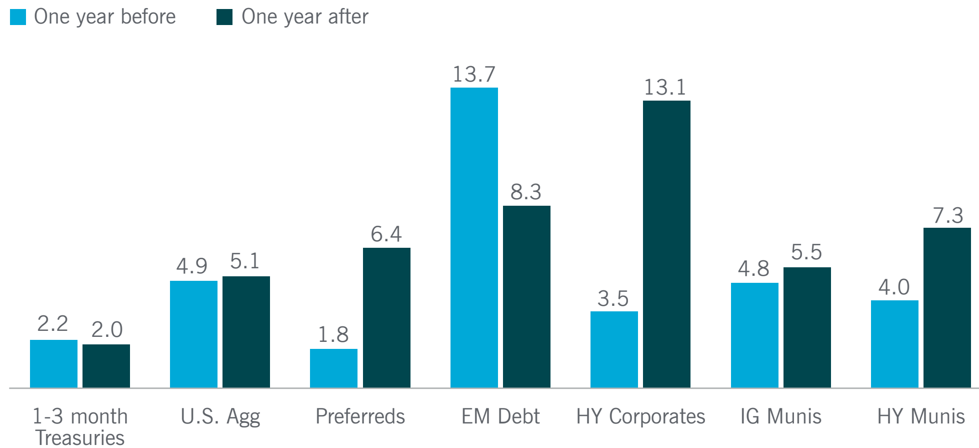
FIGURE 2: REGARDLESS OF THE OUTCOME, CREDIT SECTORS HAVE OUTPERFORMED AFTER ELECTIONS

Performance of credit sectors before and after presidential elections (%)



Data source: Bloomberg, L.P., 1996 – 2020. Data represents the average return one year before and after the past seven U.S. presidential elections. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 1-3 month Treasuries:** Bloomberg U.S. Treasury Bills: 1-3 Months; **U.S Agg:** Bloomberg U.S. Aggregate TR Index; **preferred securities:** ICE BofA Fixed Rate Preferred Securities TR Index; **emerging markets debt:** JPMorgan EMBI Plus Indices TR Index; **high yield corporates:** Bloomberg U.S. Corporate High Yield Bond TR Index; **investment grade municipals:** Bloomberg Municipal Bond TR Index; **high yield municipals:** Bloomberg High Yield Municipal TR Index. For term definitions and index descriptions, please access the glossary on nuveen.com.

Fixed income allocations that get our vote. In the taxable space, we see attractive opportunities in both investment grade and below-investment grade categories. **Preferred securities** are a worthy candidate among investment grade sectors. Preferreds are underpinned by fundamental strength in U.S. banks (the largest issuers of these securities), all of which passed the Fed's 2024 stress tests in June. We especially favor $1000 par preferreds, which currently offer nearly two units of yield per unit of duration. As for below-investment grade sectors, **high yield corporate bonds** are yielding over 7%, particularly compelling in light of how much credit quality has improved in recent years. Additionally, interest coverage ratios (a measure of a company's ability to service its debt) remain healthy for high yield issuers, and only a small portion of the debt held by the sector will be maturing in the next few years.

Municipal bond exposures that lead in our polls. The municipal yield curve is positively sloped, rewarding investors for extending duration. **High yield municipal bonds**, which feature longer durations, currently provide a taxable-equivalent yield close to 9%. And about 75% of the Bloomberg High Yield Municipal Bond Index is made up of BB rated (higher-quality) issues. In fact, broad high yield munis recently marked

their second-longest period since 1987 without a Chapter 9 bankruptcy petition. Against this sound credit backdrop, we expect defaults to remain low, rare and idiosyncratic.

Municipals are also benefiting from robust investor demand. Year-to-date, flows into the asset class have been significant, with long-term maturities (10+ years) garnering the most interest. And though high yield muni spreads have tightened, this has been driven by steady demand. We expect both the demand and spread tightening trends to continue, as investors seek to lock in attractive yields ahead of interest rates shifting downward across maturities.

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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

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Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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