

Flexible Income

Marketing communication | As of 30 Sep 2024

- **In the third quarter, the Flexible Income Strategy underperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, on a gross- and net-of-fees basis.**
- **Market interest rates declined sharply during the quarter amid cooling inflation and the Federal Reserve's 50-basis-point rate cut in September. The bellwether 10-year Treasury yield fell 55 basis points, to 3.81%.**
- **Total returns across fixed income asset classes were strong for the quarter. The Bloomberg U.S. Aggregate Bond Index advanced +5.2%, led by investment grade corporate bonds (+5.8%) and mortgage-backed securities (+5.5%). Outside the benchmark, preferred securities (+6.1%) were among the top performers.**

Market review

U.S. and global economies continued to expand during the third quarter, although more signs of a slowdown emerged. Second-quarter U.S. gross domestic product (GDP) growth came in stronger than expected at a solid 3.0% pace versus the prior year, while full-year growth is tracking just slightly below that rate. Monthly U.S. job creation moderated significantly during the quarter versus the first half of the year, causing unemployment to rise above 4%. However, layoffs and outright job losses remained rare. At the same time, U.S. consumption continued to expand at a healthy pace as illustrated by robust retail sales, while the housing market showed early signs of rebounding.

Amid further signs of moderating U.S. inflation and the weakening labor market, Fed policymakers made a supersized 50-basis-point (bp) rate cut at their September meeting. Following the meeting, however, Chair Jerome Powell asserted that a more aggressive pace shouldn't be expected going forward. U.S. Treasury yields dropped significantly across the yield curve after rising in the first half of the year. The bellwether 10-year Treasury yield ended the quarter 55 bps lower at 3.81%, while two-year rates fell by nearly twice as much. As a result, the two-to-10-year segment of the yield curve returned to an upward slope following an extended period of inversion, easing recession fears.

Total returns across fixed income asset classes were strong for the quarter with the Bloomberg U.S. Aggregate Bond Index advancing 5.20%. Preferred securities and longer duration corporate bonds led U.S. fixed income market gains for the quarter.

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Flexible Income

Portfolio review

The Nuveen Flexible Income strategy returned +4.36% (gross of fees) in the third quarter, underperforming the Bloomberg U.S. Aggregate Bond Index, which returned +5.20%. All major asset classes in the strategy posted positive returns during the period. The strategy's overweight in investment grade corporates was the top outperformer. However, shorter-duration positions within high yield and preferreds lagged the benchmark given the broad decline in interest rates, which provided a greater lift to longer-duration assets. At quarter-end, current yield and yield to worst for the institutional representative account were 5.03% and 4.72%, respectively.

The strategy's allocation to investment grade corporates was the largest contributor to returns for the period, rallying on the back of a sharp repricing in interest rates amid the larger-than-expected 50 bps policy rate cut by the Federal Reserve. Investment grade spreads also retraced tighter upon the news after backing up in August. The portfolio's overweight in higher-yielding BBB-rated credits provided nice carry, with our longer-duration holdings among the top contributors. Similarly, high yield corporates gained and continued to see strong investor demand given attractive all-in yields.

Preferred securities were another meaningful contributor to performance. The portfolio's holdings benefited from the rate and spread compression during the period. The \$25 par preferred market massively outperformed the \$1000 par market, driven by strong retail flows.

Performance in convertibles was mainly beta driven, getting a lift from strong performance in the equity market. Within the allocation, one of our industrial holdings underperformed due to weaker financial results. Lastly, common stocks rebounded after a negative prior quarter and posted strong returns given the risk-on sentiment.

Portfolio positioning

The strategy maintained a balanced, diversified exposure across asset classes, focusing on up-in-quality security selection. We continued to lean into companies with strong balance sheets, sound capital structures and durable free-cash-flow generation. Yields across credit markets remained relatively high throughout the period, enabling the investment team to find opportunities to bolster the portfolio's income.

We are mindful of stretched valuations across risk assets and were tactical in reducing exposure to names that have

reached our price targets, while rotating into areas that offered better relative value. Over the quarter, the team made modest adjustments to the portfolio's asset allocation. Shifts were mainly driven by investment decisions at the security level based on risk/reward rather than strategic or macro-based changes in the team's market outlook.

An area where the team found value was in hybrid debt securities, which sit between senior debt and preferreds in the capital structure. These securities offered very favorable income due to their subordination, which we believed was an attractive risk/reward play given that they are also issued by investment grade issuers in highly regulated industries such as utilities. Given the unique nature of the Flexible Income strategy in terms of having full access to the entire capital structure from senior debt down to equity, the team participated in opportunities in new issue and secondary markets to generate yields in excess of traditional bonds.

Outlook

We anticipate economic growth to moderate to a below-trend place. U.S. job growth is likely to soften further in the months ahead and presents upside risks to the unemployment outlook. Inflation globally has likely peaked, but will remain above central bank targets through this year. Nevertheless, the focus on monetary policy should continue to shift away from inflation-fighting and toward shoring up the economy.

We expect the Fed to continue easing at a pace of 25 bps per meeting through the middle of 2025. This would bring the policy rate down to about a neutral level of 3.25% - 3.50%. The European Central Bank is set to lower rates further as well, with our forecast calling for 125 bps of cuts through the middle of 2025. In China, policymakers are likely to extend their fiscal policy support, though substantial monetary easing is unlikely.

The recent rally in U.S. rates has moved to levels in line with our forecasts, and long-end yields should be rangebound over the coming months. We can expect more volatility in the coming months amid the U.S. election and heightened geopolitical risks, potentially creating more compelling entry points to redeploy capital. That said, we think spreads will be mostly range-bound as corporate fundamentals remain solid and default rates stay relatively benign. There have been several prior periods of tight credit spreads, including in the late 1990s, mid 2000s and late 2010s. In each instance, spreads stayed at tight levels for several years until an exogenous shock derailed economic expansion. This should set up spread sectors to delivery attractive carry and

Flexible Income

healthy excess returns moving forward, despite limited room for spreads to compress further.

Corporate earnings and equities should be supported as the economy guides towards a soft landing and the Fed cuts rates. We see market breadth expanding moving forward and expect the performance in big tech to be more balanced going forward as market enthusiasm around AI subsides.

We continue to be very focused on valuations and appropriately compensated for risk-taking. We are actively monitoring market conditions and looking for opportunities to take advantage of mispricings in the asset classes in which we invest.

For more information contact: 800.752.8700 or visit nuveen.com

Important information on risk

All investments carry a certain degree of risk of loss and there is no assurance that an investment will provide positive performance over any period of time. Debt and fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinate to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk and adverse economic developments. Concentration in the financial services sector may involve greater exposure to adverse economic or regulatory occurrences. Equity investments are subject to market risk, common stock risk, covered call risk, short sale risk, and derivatives risk. Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other style investing during given periods.

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Glossary

The **Bloomberg U.S. Aggregate Bond Index** tracks the performance of U.S. investment-grade bonds. **It is not possible to invest directly in an index.** Clients should consult their financial professional regarding unknown financial terms and concepts.

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