

## CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

# Where to invest if consumer strength fades

## Bottom line up top

- **Consumers have wind in their sails, powering retail sales.** According to data released last week by the Commerce Department, U.S. retail sales (a measure of purchases at brick-and-mortar stores, online shopping platforms and dining establishments) climbed for the fourth consecutive month in July, and at the fastest pace (+0.7%) since January. This is yet another sign that consumer spending remains a key driver of the U.S. economy's resilience, even in the face of sticky inflation and higher-for-longer interest rates.
- **Where is consumer spending power coming from, and will it last?** Spending has been helped immensely by a resilient labor market, which has boosted personal income and wage growth, and by excess savings. Additionally, the University of Michigan's index of long-run consumer inflation expectations dipped to 2.9% in early August, accompanied by overall consumer sentiment that remained essentially unchanged from July's strong showing. A recent study by Strategas Securities indicated that a consumer stress metric related to food-at-home costs, mortgage rates and gasoline prices fell to its lowest level since December 2021 (Figure 1).
- **Caveat consumer (and investor).** The strength of employment is a double-edged sword, as labor demand continues to outpace supply, putting upward pressure on average hourly earnings. This feeds into the U.S. Federal Reserve's continued hawkishness, with inflation still above the central bank's 2% target despite recent disinflationary trends. The potential for additional Fed rate hikes after a likely pause



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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.

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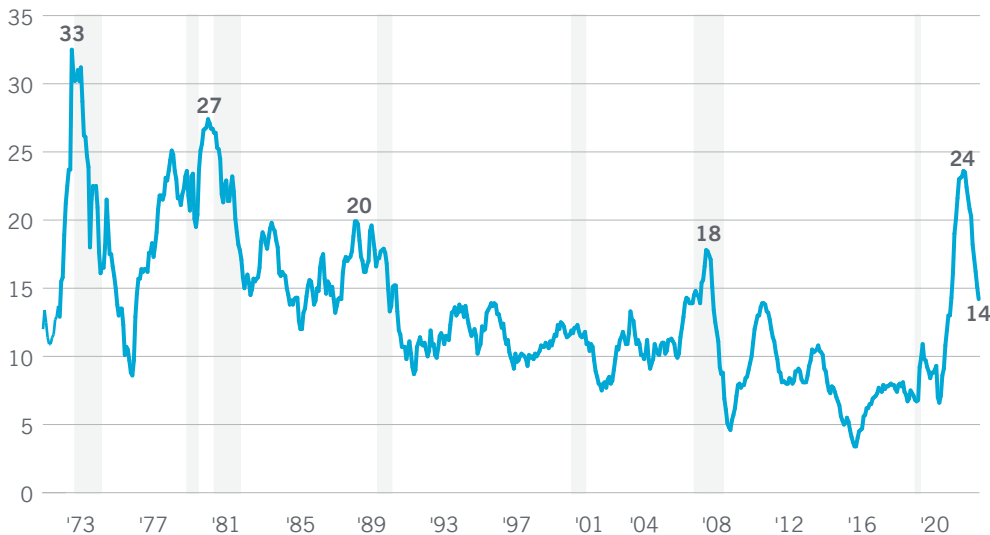
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*The strength of employment is a double-edged sword, as labor demand continues to outpace supply.*

at its September meeting, combined with a decrease in excess savings, could weaken consumer momentum as we move toward the end of the year. Another caution flag is burgeoning consumer credit card debt, which surpassed \$1 trillion in June for the first time ever.

**FIGURE 1: CONSUMER STRESS IS DECLINING FROM ITS PEAK**

*Consumer stress indicator (food at home + mortgage rates + gasoline prices) (%)*



Data source: Strategas Securities, LLC., 31 Jul 2023. Shaded areas indicate periods defined as a recession by the NBER.

## Portfolio considerations

A potential softening in consumer strength over the next few quarters could determine whether or not the U.S. economy falls into recession. Although we expect any recession to be mild, investors may want to prepare by allocating to asset classes that historically have been more insulated during recessionary environments, and provide attractive returns in elevated inflation environments. **Private credit** is one of the few asset classes that has done both. Within private credit, we favor shifting away from cyclical areas that are closely tied to the consumer, such as retail and restaurants. If consumers decide to tighten their purse strings, dining out would likely be one of the first targets for curtailed spending.

In contrast, the business services sector is less exposed to discretionary spending. Consulting firms that provide design support for infrastructure projects offer a compelling example. Municipalities hire these companies to design and engineer facilities or systems that provide essential services, such as water treatment plants and roads. Municipal balance sheets are fiscally

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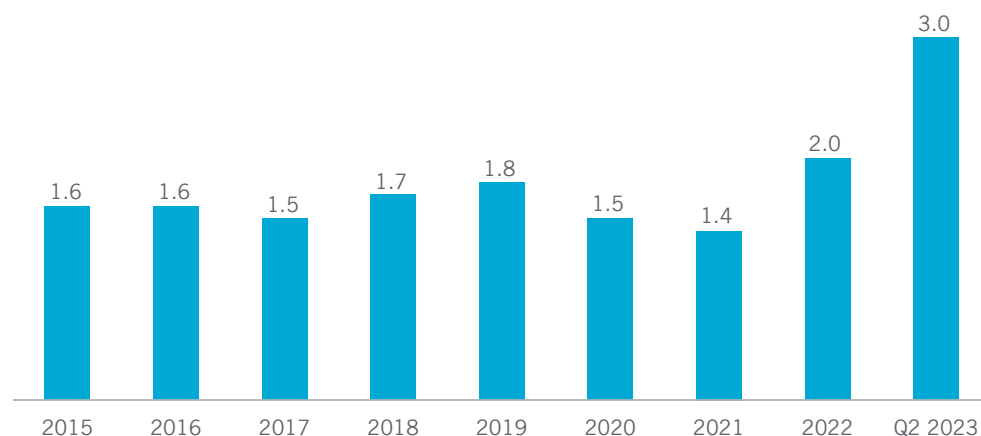
fit, with cash reserves at their highest levels in more than 40 years and low capital expenditures that have produced healthy margins. The federal Infrastructure Investment and Jobs Act of 2021 is another tailwind, having already reserved funds for these types of projects.

Also representing attractive opportunities within business services are companies that perform regular maintenance on HVAC systems, including the replacement of equipment when needed. Homeowners need to maintain their air conditioning and heating units and are less likely to pull back their spending in this area, even if income or savings decline. This inelastic consumer demand creates recurring revenue to companies that provide these services.

Lastly, risk-adjusted returns for private credit have become increasingly attractive. The all-in yield per unit of leverage was quite stable from 2015 to 2021, but, based on our calculations, it has climbed quickly due to rising rates and spreads as leverage levels have declined (Figure 2). Since 2021, the ratio has more than doubled, from 140 basis points (bps) to 300 bps.

**FIGURE 2: PRIVATE CREDIT YIELDS HAVE CLIMBED SINCE THE FED STARTED HIKING**

*All-in yield per unit of leverage (%)*



Data source: Nuveen calculations of private credit markets. 16 Aug 2023. Performance data shown represents past performance and does not predict or guarantee future results.

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*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

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### Endnotes

#### Sources

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

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