

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Fundamentals, not rates, drive senior loans

Bottom line up top

Data-dependent pledge is definitive, but the data itself?

Markets basking in the glow of the U.S. Federal Reserve's late-summer rate cut may have turned chillier last week as the calendar ushered in a batch of stronger-than-expected economic data that may have clouded the forecast for more Fed easing. Chair Jerome Powell has remained adamant about the central bank's data-dependent approach, insisting at his 17 September press conference that "we're not on a preset path, and we really mean that." He described that day's 25 basis points (bps) rate cut as a "risk-management" move, not necessarily the beginning of a full easing cycle.

Markets undoubtedly recalled those words as they digested last week's data releases indicating resilience in the labor and housing markets, among other areas:

- Initial unemployment claims fell by 14,000 to 218,000 — the lowest weekly level since mid-July. Continuing claims dipped slightly, with the insured unemployment rate holding steady at 1.3%, indicating that the number of people already receiving benefits is not increasing significantly. On balance, employers appear to be retaining workers, and while hiring may be moderating, there's little sign of accelerating job losses or a sharp decline in labor demand. On the housing front, both new and existing home sales surprised to the upside amid a drop in mortgage rates.
- Preliminary U.S. purchasing managers' indexes (PMIs) for September remained above the 50 level that signals economic expansion, with business sentiment improving despite slightly softer demand growth



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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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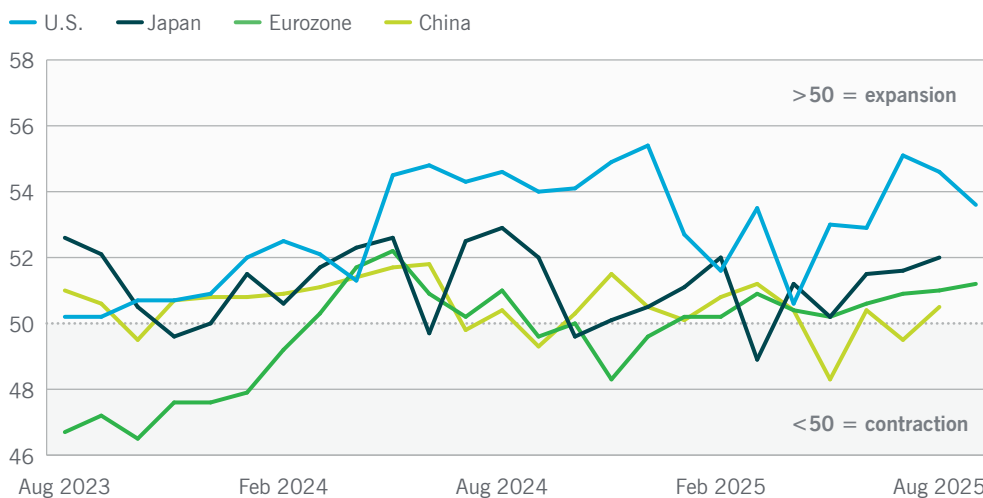
and slower hiring. Figure 1 compares composite PMIs encompassing both manufacturing and service-sector activity for the U.S., eurozone, Japan and China.

Inflation got the last word last week. The core Personal Consumption Expenditures (PCE) Price Index, which excludes the volatile food and energy components and is the Fed's preferred inflation barometer, was essentially unchanged in August, at 0.2% for the month and 2.9% year-over-year. But it was still above the Fed's 2% target, and combined with last week's encouraging signs in the labor market, could temper market expectations for additional rate cuts.

Ultimately, given the fragile balance between growth and inflation risks, and growing concerns about a government shutdown, markets face what could be an uncertain final two months of the year. In this environment, investors may want to consider allocating to an asset class like senior loans, which offer attractive yields and favorable risk-adjusted return potential regardless of when and to what extent the Fed decides to cut rates again.

FIGURE 1: PMIs HAVE REBOUNDED SINCE APRIL TARIFF SHOCKS

Global purchasing manager indexes (PMIs)



Data source: Bloomberg, L.P., 23 Sep 2025. PMI data is based on the S&P Global Composite Indexes. For the U.S. and eurozone, flash PMIs (preliminary data) for September 2025 are shown.

Portfolio considerations

Senior loans, also known as syndicated loans, are directly affected by Fed policy. When the Fed lowers the target fed funds rate, the risk-free rate of return declines. (This rate — the theoretical return on an investment carrying zero risk of financial loss — is the baseline to which a credit spread is added to calculate senior loan yields.) The relationship between

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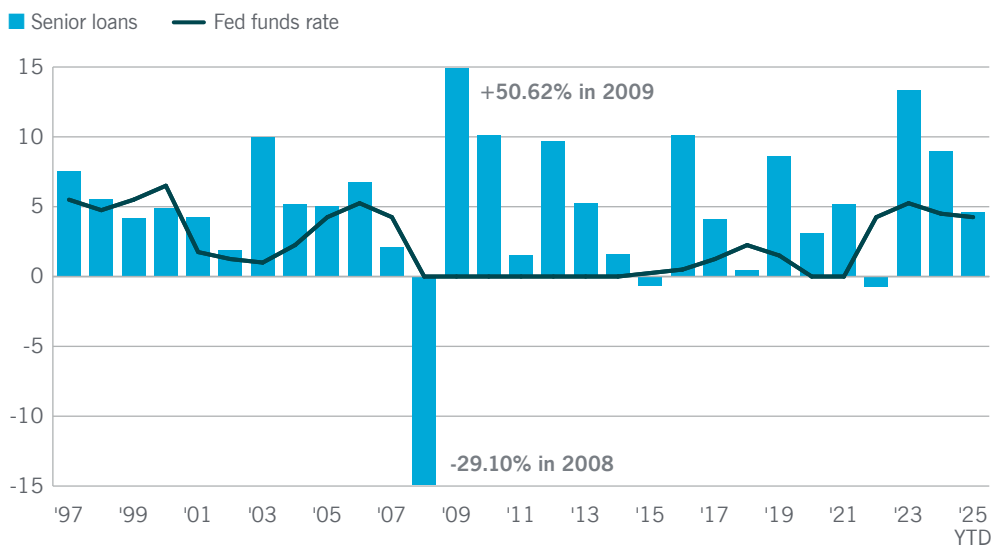
Fed easing, the risk-free rate and yields has led to the false perception that senior loans can't perform well in falling rate environments. In fact, since 1997, loans have posted positive total returns in eight of the nine years when the Fed lowered rates (Figure 2). Their only negative year during a Fed easing cycle was 2008, when the global financial crisis drove all risk assets lower.

Lower interest rates improve fundamentals for loan issuers by reducing their interest expense, resulting in potential credit spread tightening. Although some recent economic data, notably labor market indicators, have weakened, corporate fundamentals remain broadly healthy for leveraged finance borrowers. The three-year senior loan yield, for instance, stood at 7.75% as of 22 September. Additionally, even with a combined 75 bps of further easing expected by the end of 2026 (per the Fed's latest dot plot), the starting yield for loans will still be near their highest level in more than 15 years, offering compelling entry points.

Lastly, rather than interest rates, the main driver of loan performance is credit risk, which in turn reflects general economic strength and credit fundamentals. With the economy still showing resilience and loan issuers in sound financial shape, we expect the asset class to continue to offer equity-like returns with only a fraction of the volatility. In fact, senior loans have delivered the highest risk-adjusted return among taxable fixed income sectors over the past 10 years.

FIGURE 2: LOANS HAVE HISTORICALLY PERFORMED WELL DURING PERIODS OF FALLING RATES

Senior loan returns versus fed funds rate (%)



Data source: Morningstar, 22 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative index: Senior loans: Morningstar LSTA US Leveraged Loan Total Return Index.

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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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