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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

# Stocking up on dividend growth as economy slows

## Bottom line up top

**Can the "Steady Eddie" Fed avert a recession?** A recent spate of weaker-than-anticipated economic data has some investors believing (or at least hoping) that the U.S. Federal Reserve will cut interest rates by as much as 50 basis points (bps) this week. While a move of that magnitude might help alleviate concerns that the end of the Fed's historic tightening cycle may be too little, too late to prevent a recession, Fed Chair Jerome Powell has made it clear that the central bank doesn't want to cut rates too much, too early — as this could potentially reaccelerate inflation after two years of hard-fought progress in lowering it. Last week's release of the Consumer Price Index (CPI) for August served as a reminder to policymakers and investors alike that the inflation battle isn't quite over yet, as the core CPI rate unexpectedly ticked up from July's level. We believe the Fed will remain vigilant and take a measured approach to easing monetary policy. This implies an initial rate cut of 25 bps on Wednesday rather than 50.

**Voting "yes" on fixed income, but equity portfolio positioning is trickier.** Yields on bellwether 2-year and 10-year U.S. Treasury notes have fallen precipitously from their 2024 highs, leading bond markets to rally on slower economic growth and rate cut expectations (Figure 1). While the decline in yields has driven attractive fixed income returns, conditions that favor an ongoing rally in bond markets may be less supportive of equity markets. Corporate earnings, for example, might be pinched as inflation and economic activity decelerate. Accordingly, we continue to favor equity allocations that focus on companies with defensible margins and resilient cash flows.

**Saira Malik, CFA**
*Head of Nuveen Equities and Fixed Income, Chief Investment Officer*

*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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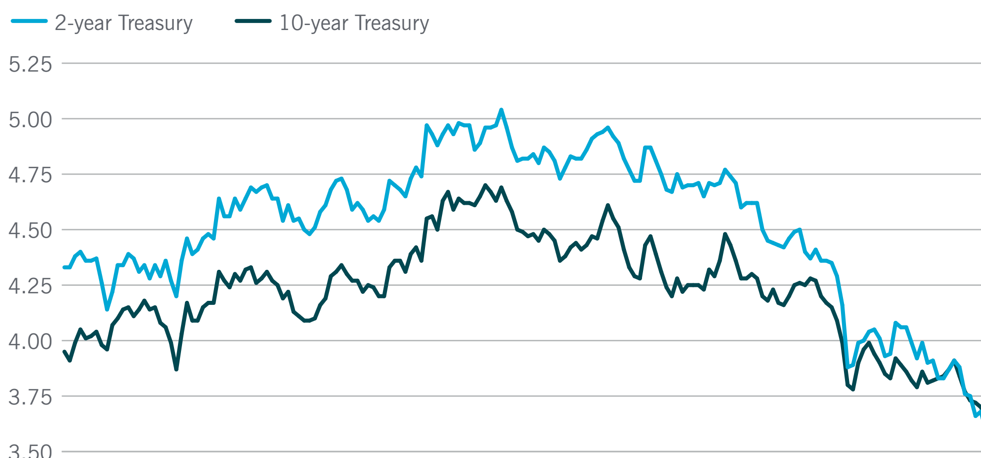
> *We expect the Fed to cut rates for the first time this cycle later this week, but economic growth is likely to continue to slow.*

**FIGURE 1: FALLING YIELDS HAVE HELPED BOND MARKETS BUT MAY PRESSURE EQUITIES**

*U.S. Treasury yields (%)*




Data source: U.S. Department of the Treasury, as of 10 Sep 2024. **Past performance does not predict or guarantee future results.**

## Portfolio considerations

**A less rocky road to travel when the VIX is vexing.** Equity markets have been choppy lately amid substantially weaker labor market data and slowing in the broader economy. The CBOE Volatility Index (VIX), a measure of implied volatility of the S&P 500, has increased over recent weeks, hitting 38.6 in early August, well above its long-term average of 18.2. Given worries about economic growth and heightened political uncertainty ahead of the U.S. elections, we expect volatility to remain elevated. This backdrop favors defensive equities, especially dividend growers, which offer more attractive valuations and have historically been less volatile relative to the overall stock market.

Many portfolios are overweight U.S. large cap growth equities, which has been a winning strategy over the past decade. Recently, however, that part of the market has tended to sell off and underperform dividend growers as stocks have been spooked by weak economic data. For example, during the first three trading days of August, a surprisingly soft batch of employment metrics drove both the broad equity market (S&P 500 Index) and the large cap growth category (Russell 1000 Growth Index) down by more than -6%. In contrast, the S&P 500 Dividend Aristocrats Index took a much lighter hit (losing just over -2%), remaining more resilient during this "flight to safety" within risk assets. Additionally, dividend growers have historically been an effective diversifier of large cap growth stocks, the largest allocation in many investor portfolios. Figure 2 quantifies this diversification advantage based on dividend growers' negative excess return correlation compared to large cap growth versus the S&P 500.

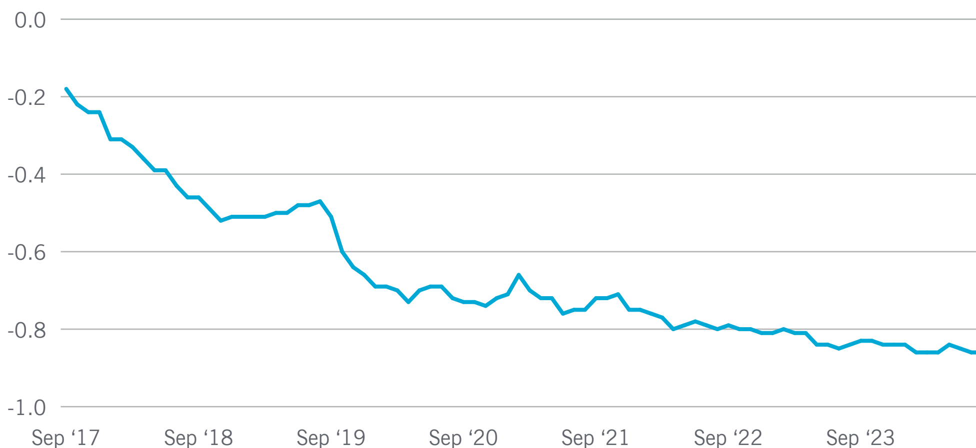
**Dividend growth companies offer the potential for strong returns, lower volatility and diversification versus the broader stock market.**

Meanwhile, though inflation has moderated, it remains above the Federal Reserve's 2% target. A further downward trajectory may not be smooth, and it will take time for inflation to fully normalize. The combination of capital flexibility and balance sheet strength that dividend growth companies enjoy should help them mitigate inflationary input cost pressures, and thereby maintain or even expand profit margins – ultimately a plus for shareholders.

Over time, companies that have initiated or continued to raise dividends have historically generated higher annualized returns with lower annualized standard deviation versus the broader market. Companies are typically reluctant to cut their dividends, since that can signal stress to investors. On the other hand, companies that continually increase their dividends are bearing the fruit of robust business models and cash flows. We believe the potential combination of attractive risk-adjusted returns and less volatility makes dividend growers a sound choice for a core portfolio allocation.

### FIGURE 2: DIVIDEND GROWTH STOCKS HAVE HISTORICALLY OFFERED NOTABLE PORTFOLIO DIVERSIFICATION

*Excess return correlation of dividend growth and large cap growth versus the S&P 500 Index*




Data source: Bloomberg, L.P. as of 30 Aug 2024. The data depicts the correlation between the combined excess return of the **S&P Dividend Aristocrats TR Index** and **Russell 1000 Growth Index** versus that of the **S&P 500 Index** on a rolling three-year basis. The start date for the comparison reflects the common inception point of all three indexes. **Correlation is a statistical measure of how two variables move in relation to each other. Negative correlation indicates the variables have historically moved in opposite directions. Past performance does not predict or guarantee future results.** For additional term definitions and index descriptions, please access the glossary on nuveen.com.

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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

### For more information, please visit nuveen.com.

**Endnotes**

**Sources**

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

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