

Power move: plugging portfolios into electricity demand trends

Bottom line up top

Float like a butterfly, sting like a bee. The economic data calendar was light last week but punched above its weight class in terms of impact. U.S. flash (preliminary) purchasing managers indexes (PMIs) for September landed the first blow, as the composite reading for manufacturing and services activity surged to 58.4 — pummeling both consensus forecasts (55.7) and August's print (56.0) to deliver its strongest performance since July 2021. (PMI levels above 50 signal economic expansion.). New orders accelerated, and employment growth reached its fastest pace in more than four years. These knockout results came despite rising fuel and transportation costs, underscoring continued economic resilience.

Oil prices have been rebounding alongside robust growth signals, with the Brent crude benchmark back above \$100 per barrel and diesel prices hitting new all-time highs, adding inflationary pressure across nearly all corners of economic activity given diesel's primary role in the transportation of goods.

Perhaps more bruising for financial markets is the recent runup in U.S. Treasury yields (Figure 1). The 10-year rate has moved above 5.1%, a nearly 19-year peak, while the 30-year is near 5.5%, a level not seen since 2004. The catalysts are copious, encompassing not just the robust economic activity that's pushing up real yields and elevated energy prices that are fueling inflation jitters, but also heightened expectations for further Federal Reserve rate hikes.

Don't knock all the knock-on effects. Higher Treasury yields tighten financial conditions across mortgages, corporate credit and real estate, while raising discount rates used to value financial assets. Equities — especially richly valued, long-duration growth stocks — may be vulnerable to a selloff if investors decide they'd rather take advantage of the currently elevated risk-free rates that Treasuries represent than risk future potential losses by holding on to stocks that might never reach their lofty growth targets. Leveraged private-market assets may also feel pressure. But not all potential impacts are negative: Higher yields improve prospective income opportunities across fixed income and have helped the U.S. dollar firm after trending weaker during most of the third quarter.

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CIO WEEKLY COMMENTARY

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*On behalf of
Nuveen's Global
Investment Committee*

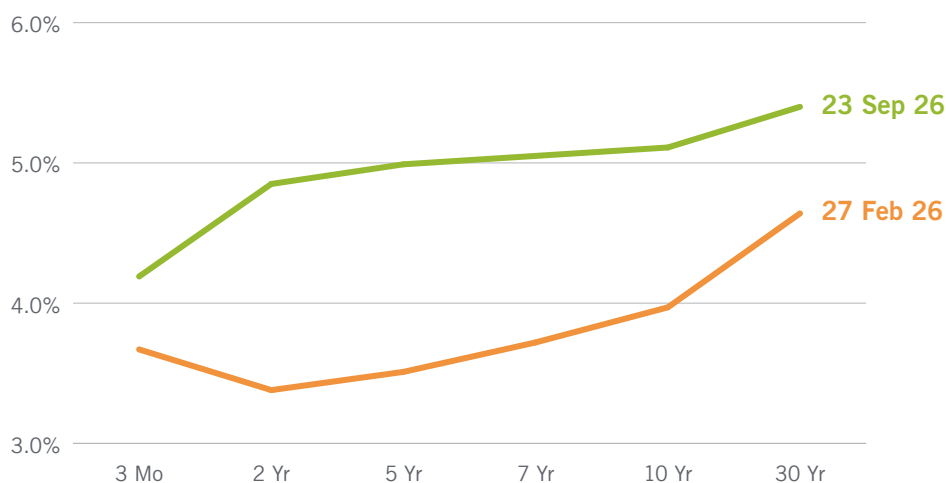
As Nuveen's Chief Investment Officer and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she is a portfolio manager for several key investment strategies.

Beyond the cyclical pressures of tighter monetary policy and elevated yields, a larger structural investment story continues to build. Soaring electricity demand — driven by the boom in AI data centers and the electrification of the broader economy, among other factors — is creating an enormous and ever-growing need for new power generation, transmission and supporting infrastructure. The result for investors: opportunities to tap the massive potential that's powering the next generation of the U.S. economy.

Figure 1

Upward pressure mounts on U.S. Treasury yields

Treasury yield curve shifts since the end of February



Data source: U.S. Department of the Treasury.

Portfolio considerations

The megatrend of booming demand for power generation continues to gain momentum in the global economy and financial markets, with the latest data and forecasts reinforcing the durability of the theme. In the United States alone, we expect power demand to surge by around 60% over the next 20 years — about six times the relatively flat growth rates seen between 2005 and 2025.

Massive amounts of capital will be required to meet this historic shift in demand, which is being driven by factors such as the need to replace aging assets, relieve overtaxed power grids and provide storm protection. The most notable of these catalysts is the exponential growth in data centers to support the expansion of AI. Global research firm Gartner forecasts worldwide AI spending will top \$2.5 trillion in 2026, approaching \$3.5 trillion in 2027 —with nearly 55% of that capital flowing into AI infrastructure. This level of spending translates directly into vastly increased electricity consumption, with data center power demand projected to surge more than 240% between 2024 and 2030.

Businesses with greater exposure to power generation stand to benefit the most from rising energy demand and tightening electricity markets. This thesis isn't

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Higher oil prices are pushing bond yields higher, but they also create investment opportunities in energy-related infrastructure.

lost on electric utility companies, whose increasing capital expenditures (capex) to harness that potential are well underway. Per the Edison Electric Institute, total functional spending by U.S. public electric utilities climbed by nearly \$100 billion between 2015 and 2025, with generation-related capex accounting for close to \$30 billion of that total (Figure 2). We expect this trajectory to persist and view it as a durable tailwind for utility earnings and cash flow growth over the coming decade.

While utilities anchor this theme, we see complementary investment opportunities elsewhere, including natural gas infrastructure. Natural gas continues to bridge the supply gap left by coal plant retirements and intermittent power generation issues for renewable energy sources like solar and wind (e.g., lack of production in low-light or windless conditions). Over the longer term, we expect this sort of intermittency in the renewables space to improve amid the ongoing buildout of utility-scale solar and energy storage, creating further potential opportunity.

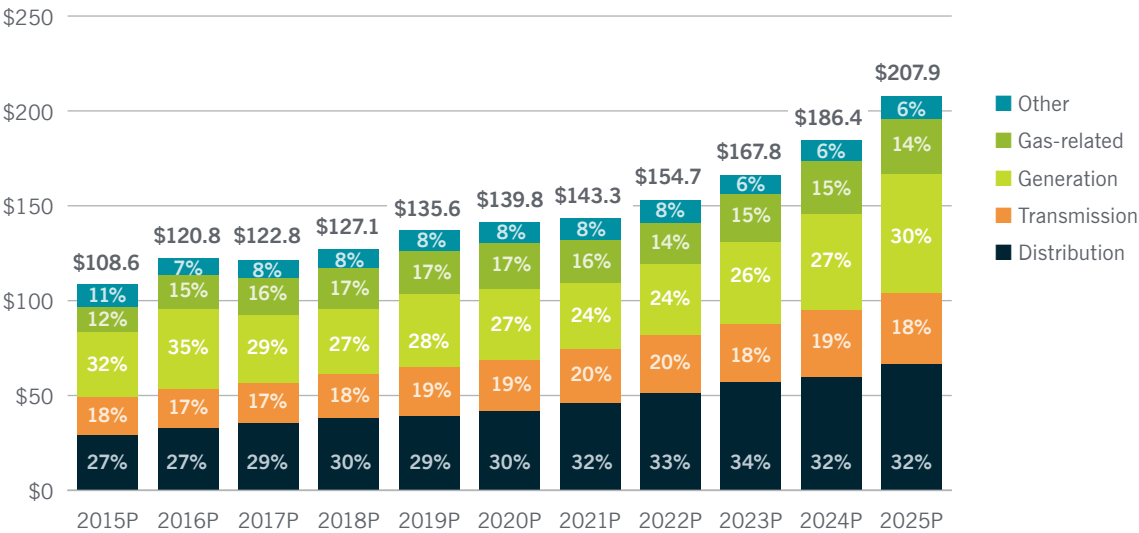
As with any nascent secular theme, there are risks and caveats. Rising capex is beginning to show up in the form of higher customer utility bills. In states with already-elevated electricity rates, regulatory scrutiny and local resistance to new data centers could slow project approvals and pressure returns. We believe active management can help identify fundamentally sound companies with constructive regulatory relationships, effective community engagement practices and, in some cases, more sustainable environmental footprints. In our view, focusing on these characteristics is essential to navigating the inherent risks that accompany the potential rewards of this compelling long-term structural opportunity.

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Investments focused on power generation such as electric utilities and natural gas infrastructure appear particularly compelling.

Figure 2

Electric utility infrastructure spending continues to climb

Projected functional capex (\$ billions)



Data source: Edison Electric Institute, based on EEI member company reports. Data depicts the projected total functional capital expenditures of U.S. public electric utilities.

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Endnotes

Sources

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

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