nuveen
A TIAA Company

CIO Weekly Commentary
09 October 2023

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

U.S. equity allocations amid earnings and economic uncertainty

Bottom line up top

Will one recession end as another begins? Whichever optimist came up with "When one door closes, another one opens" didn't have earnings and economic recessions in mind. But with third quarter earnings season underway, many investors hope earnings growth for S&P 500 companies will be back in positive territory after three consecutive quarters of decline. If that happens, the door will close on the earnings recession — and unlike in the old aphorism, this closed door is a good thing. As of 06 Oct, current blended earnings growth estimates for the S&P 500 are only modestly negative (-0.3%). The bad news is concentrated in the energy sector, which is still contending with base effects from strong earnings growth in 2022 (Figure 1).

The current U.S. earnings recession is one of the few that did not coincide with a recession in the broad economy. On the other hand, the U.S. has never experienced an economic recession that did not include at least two consecutive quarters of negative earnings growth. This relationship between earnings and economic recessions warrants caution, as our base case outlook still calls for the economy to contract, albeit mildly, sometime in 2024. This is another door opening, but in this case to an economic recession.

Margins may hold the key to the door. Although earnings have shown some improvement, and at the broad index level are largely in line with longer-term averages, deciding on specific equity allocations

Saira Malik, CFA
Chief Investment Officer

On behalf of Nuveen's Global Investment Committee

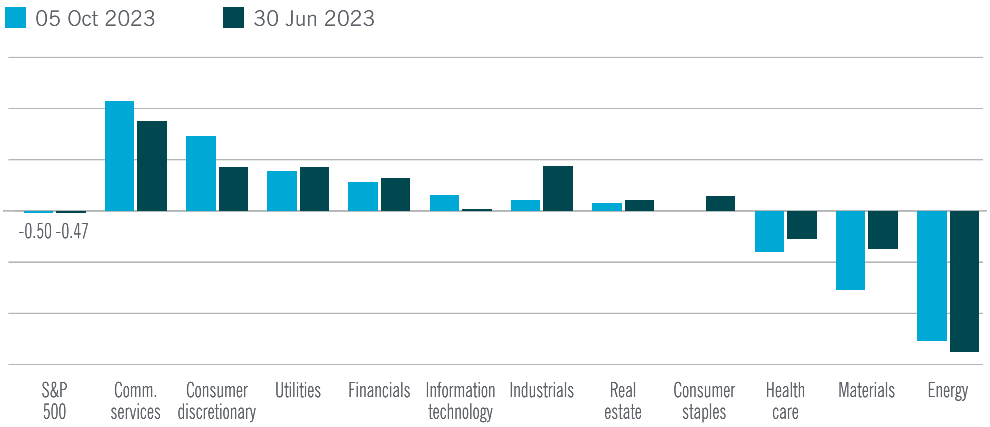
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's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

isn't an open-and-shut case. But high-quality cash flows and defensible margins are a good place to start, as companies with these characteristics typically outperform during recessionary periods.

Deciding on specific equity allocations isn't an open-and-shut case.

FIGURE 1: EARNINGS GROWTH ESTIMATES VARY WIDELY ACROSS SECTORS

S&P 500 blended earnings growth estimates, third quarter 2023 (%)



Data source: FactSet, 05 Oct 2023. **Performance data shown represents past performance and does not predict or guarantee future results.** 'Blended Earnings Growth Estimates' combine the actual results of companies that have reported 3Q23 earnings with current estimates of companies that have yet to report.

Portfolio considerations

Thanks in large part to this year's U.S. equity market rally, the S&P 500 Index's price/earnings (P/E) multiple has expanded by 6.8% in 2023 through September (based on 12-month forward earnings). The S&P 500 returned 13.1% during this period, with earnings growth expectations up 4.1% (Figure 2). The resulting P/E ratio for the index is 17.9x earnings — in line with its 10-year average. While we have a neutral view on equities, our economic outlook calls for a slowdown over the coming quarters. With that in mind, and with corporate earnings season underway, we're especially mindful about where we want to allocate equity risk.

From a sector perspective, we're optimistic on information technology and health care. Tech stocks have strongly outperformed the broader market year-to-date, driven by the largest names. And their soaring share prices have been accompanied by a dramatic advantage in earnings before interest and taxes (EBIT). Within technology, we remain constructive on less-cyclical select software companies — specifically those whose revenue sources are tilted toward enterprises rather than retail consumers. Such companies tend to have resilient business models and inelastic demand.

With our expectations of an economic slowdown over the coming quarters, we are mindful on where we are allocating equity risk.

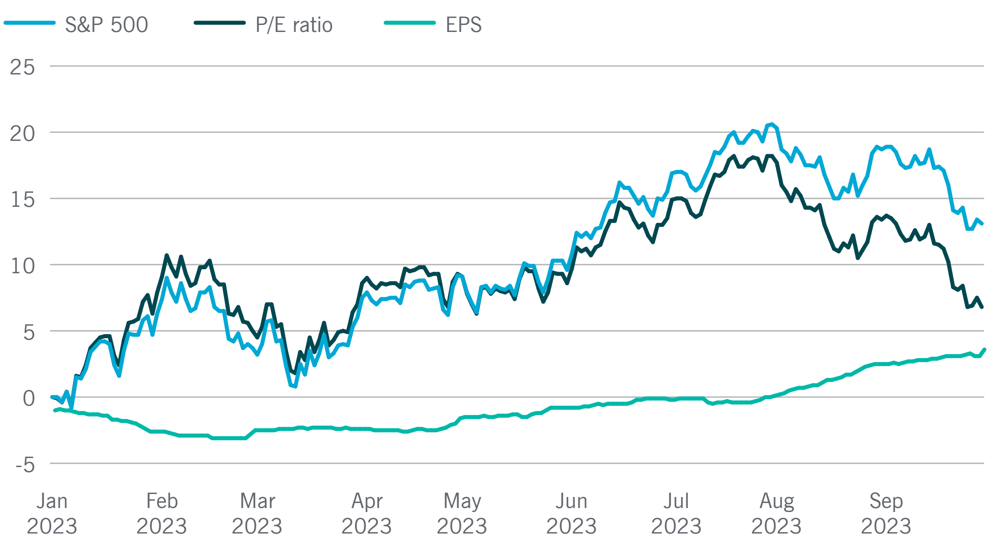
Health care is a defensive play with the potential to outperform if the economic slowdown that we expect materializes. The sector has seen its share of consumer spending expand, largely a function of higher outlays for Affordable Care Act (ACA) expenses (12% growth in 2022 and 35% growth over the past two years).

Our view on the energy sector is neutral. Energy has been in the news lately, with the daily spot price for West Texas crude oil surging 29% in the third quarter, approaching $95/barrel in late September before settling slightly below $91. But we believe further upside in oil prices is limited, and gasoline margins have peaked seasonally. On a positive note, corporate balance sheets have undergone massive repairs coming out of Covid, when equity market caps were 85% of the benchmark's enterprise value. With debt no longer a headwind, energy companies are engaging in share buybacks and paying both regular and special dividends. Upstream energy companies (those involved in exploration and production) will likely see positive earnings revisions, as the longer-dated oil curve moved meaningfully higher over the past few months.

We remain less optimistic on financials. Banks are facing regulatory pressures on capital liquidity, as well as increased competition for customer deposits. Tighter lending standards are also weighing on the banking industry, and net interest margins are under pressure.

FIGURE 2: P/E MULTIPLE EXPANSION HAS BEEN DRIVEN BY PRICE RETURN, AS EARNINGS GROWTH HAVE SURPASSED EXPECTATIONS

S&P 500 Index price, P/E ratio and EPS (%)



Data source: Bloomberg L.P., 30 Sep 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

About Nuveen's Global Investment Committee

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

For more information, please visit nuveen.com.

Endnotes

Sources

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

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature.

Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

Important information on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

Nuveen, LLC provides investment services through its investment specialists.

This information does not constitute investment research as defined under MiFID.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

845528 GWP-3155364PG-E1023P