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CIO Weekly Commentary
09 May 2022

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Headlines cause volatility, but details drive the narrative

Bottom line up top:

The devil, or in some cases the angel, is in the details. On Wednesday the economic calendar brings the April CPI inflation report, the fourth major macro metric in a span of just 10 business days. We've already seen a surprise negative GDP print, a much-anticipated Fed rate hike and a monthly payrolls report that — while broadly in line with expectations — contained some underlying inconsistencies. All four have significant and potentially market-moving implications for the economy. Interpreting them can require discerning whether the underlying specifics are as "bad" or "good" as the headline number suggests.

1. **GDP: more than meets the eye.** The government's recent -1.4% advance estimate for 1Q growth masked a considerably better-performing economic engine under the hood. In particular, final sales to private domestic purchasers — in our view, a more reliable indicator of domestic demand than headline GDP — grew at a 3.7% annualized rate. We continue to believe that, barring an unforeseen exogenous shock, a U.S. recession is not in the cards for 2022.
2. **Fed meeting: few surprises but big reactions.** As expected, the Fed raised the target federal funds rate by 50 basis points and announced it would begin reducing its $9 trillion balance sheet in June — a hawkish two-pronged strategy to normalize monetary policy quickly. Chair Jerome Powell downplayed talk of any 75-basis-point hikes, helping fuel a massive post-meeting relief rally in equities. Those gains and more were erased in the following day's market meltdown, as investors suddenly turned bearish in advance of Friday's jobs report and this week's CPI print. The sharp reversal suggests that investors may have priced in all the Fed tightening we're likely to see for now, but they haven't priced in increased odds of a recession.

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.

Evidence that monetary tightening is starting to work its way through the system could be a welcome harbinger of cooler inflation.

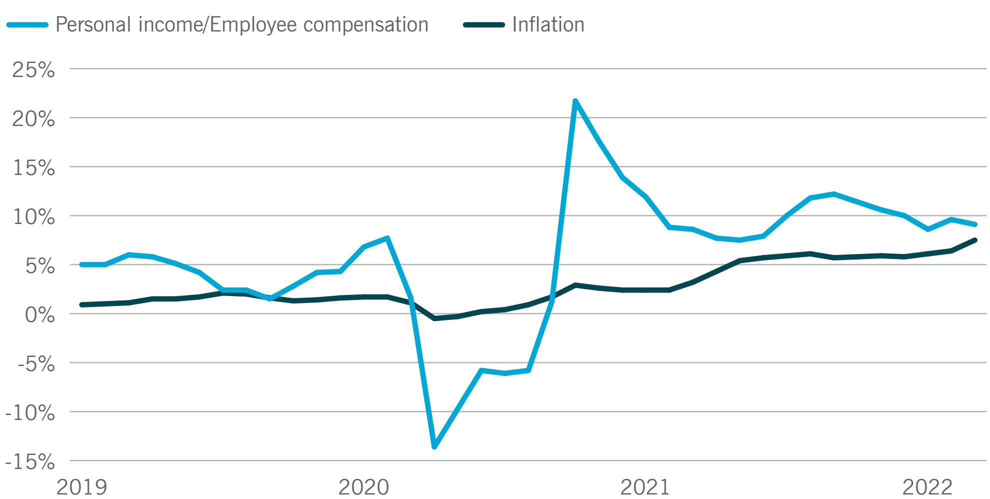
3. **Employment still robust:** The April jobs report, in our opinion, has some inconsistencies. Employment increased beyond expectations, however, the unemployment rate remained flat due to a drop in the labor force participation rate. Despite the tighter labor force picture, the average hourly earnings slightly softened. The establishment survey, which looks at private nonfarm businesses, signaled strength while the household survey indicated a pullback in employment.
4. **What's up with inflation?** April CPI data could help confirm whether we're correct in our view that inflation is nearing its peak. As always, the devil will be in the details. Energy prices will likely remain an outsized driver of inflation. As such, we will pay close attention to core CPI, which excludes food and energy inflation. We would note that the core PCE price index, the Fed's preferred inflation barometer, did not accelerate in March and actually was revised lower for February.

Portfolio considerations

Our economic base case remains intact, but market volatility should persist. Nuveen's Global Investment Committee continues to believe a recession isn't imminent, given a historically tight labor market with nearly two job openings for every unemployed person and aggregate income growth running well above inflation (Figure 1). Despite the healthy labor picture, markets are rapidly repricing to account for the odds of lower economic growth, more persistent inflation and tighter monetary conditions. Until any of these three dynamics changes, investors should expect continued market swings in both stocks and longer-duration bonds.

FIGURE 1: EMPLOYEE COMPENSATION GROWTH CONTINUES TO OUTPACE INFLATION

U.S. compensation growth and inflation, 6 month annualized (%)

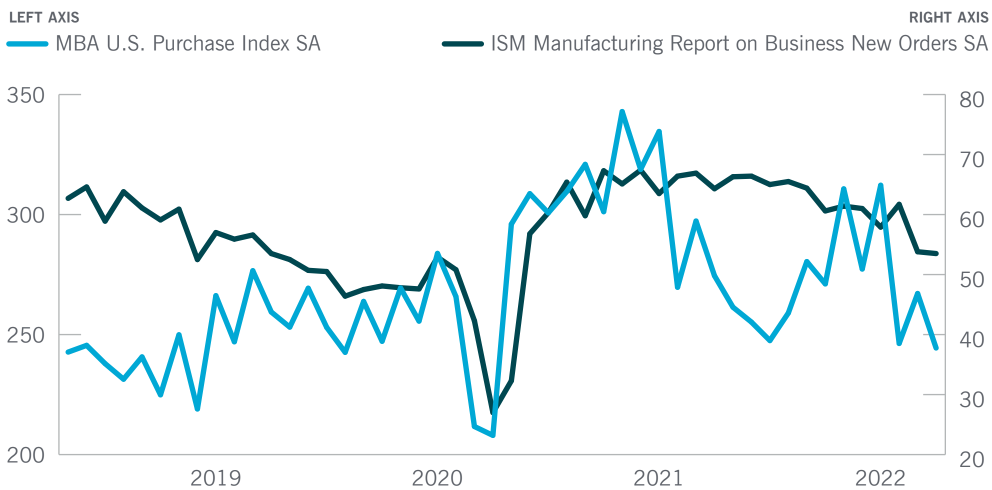


Data source: Bloomberg, L.P., 31 Jan 2019 to 31 Mar 2022.

Companies with strong balance sheets and the ability to grow dividends can be especially attractive in an inflationary environment.

Tight makes right — or at least it might. Evidence that monetary tightening is starting to work its way through the system could be a welcome harbinger of cooler inflation. For example, skyrocketing 30-year mortgage rates may be slowing housing demand, as mortgage applications for new-home purchases have fallen to pre-pandemic levels (Figure 2). And the ISM New Orders Index has returned to early 2019 levels, a potential sign of slower inventory building in anticipation of less consumer spending. Employment is important, but housing and new orders are important as leading indicators of overall economic activity.

FIGURE 2: SIGNS OF SLOWER CONSUMER SPENDING ARE APPEARING



Data source: Bloomberg, L.P., 31 May 2018 to 30 Apr 2022.

Where and how to allocate assets. If we're correct that growth will decelerate but the economy will avoid a recession, how should investors position their portfolios?

- As we discussed in last week's commentary, fixed income investors targeting the belly of the duration curve are benefiting from the highest starting yields in years. And while strong fundamentals support the broad case for corporate credit, maintaining a higher-quality bias within high yield bonds and loans is prudent in this environment. We also believe tax-sensitive investors should continue taking advantage of dislocations in the municipal market.
- Within equities, our preference for defensive exposure is dividend growers. Companies with strong balance sheets and the ability to grow dividends can be especially attractive in an inflationary environment.

Both equity and fixed income markets have had tremendously difficult year to date, to put it mildly. Unfortunately, occasional periods of pain are inevitable in the pursuit of long-term investment returns. We will continue to evaluate the data cautiously across our portfolios and keep our clients informed about where we are finding opportunities.

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.

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A word 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. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. 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. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. 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.

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