September 2024

nuveen
A TIAA Company

Navigating key risks: election uncertainty, market valuations and industry concentration

With passions around the U.S. election running high, investors are concerned an uncertain result may add to the list of U.S. equity market risks. We suggest considering defensive equity strategies to cushion downside risk and diversify concentration in the richly valued Magnificent 7.

Elections represent one risk among many

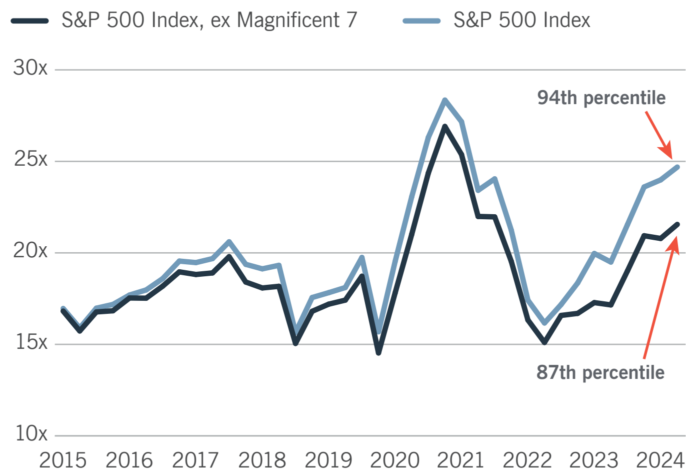
Elections have proven less significant for markets than commonly thought. History suggests that volatility generally peaks in the last months of every year, not just election years. Since December 31, 1948, September holds the lowest average return for the S&P 500 Index at -0.2%, while October and November have experienced relatively higher volatility.

Beyond seasonality, markets have been driven by valuations, earnings and the economic outlook in election years as they have in any other. We see vulnerabilities among those fundamentals today.

While valuations of the Magnificent 7 and a handful of other stocks are especially high, the S&P 500 Index excluding the Mag 7 would still rank in the 87th percentile of overall market history (Figure 1). Furthermore, general equity risk makes these names vulnerable to any overall deterioration in the growth outlook.

Figure 1: Valuations and concentration are elevated

Price/earnings ratio (LTM)



The Magnificent 7 stocks make up

31%

of the S&P 500 Index

Data source: Bloomberg, L.P., 30 Jun 2015 – 28 Aug 2024. Long-term percentiles measured from 31 Mar 1954 – 28 Augh 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** The Magnificent 7 stocks include Apple, Microsoft, Google parent Alphabet, Amazon.com, Nvidia, Meta Platforms and Tesla; weighting as of 26 Aug 2024.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

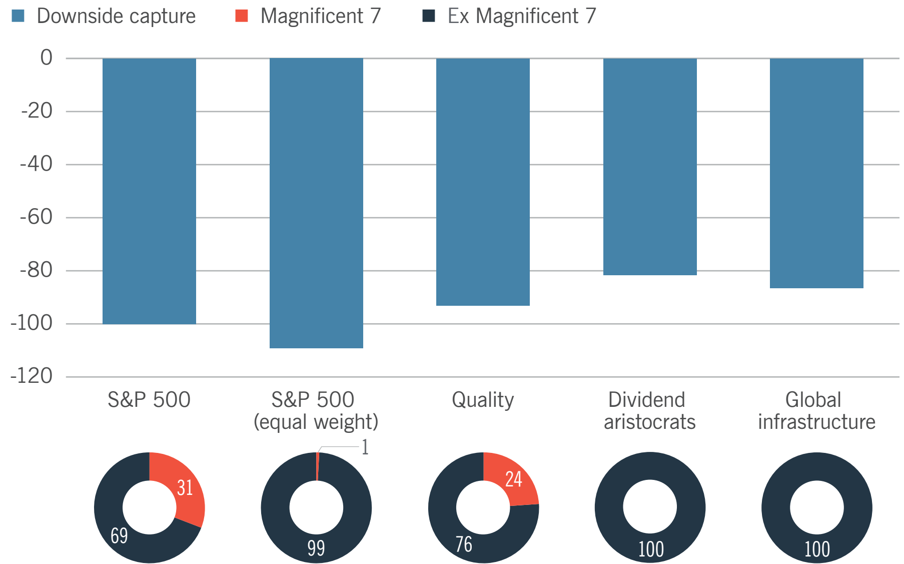
Equal weight does not mean diversification

Diversifying a portfolio concentration of large technology and artificial intelligence names is more complex than it seems.

A simple strategy of equally weighting the index is appealing in the face of concentrated equity markets. However, equal weight strategies have had higher downside capture relative to the market (Figure 2).

Alternately, investing in quality names, for example, traditionally offers defensive fundamentals, but the market is currently concentrated in these types of holdings. Meanwhile, dividend aristocrats (aka dividend growers) and global infrastructure offer defensive fundamentals, a history of low downside capture and no exposure to the Magnificent 7.

Figure 2: Defensive equity strategies: Achieving different outcomes means taking different risks



Data source: Bloomberg, L.P. **Performance data shown represents past performance and does not predict or guarantee future results.** Weights as of 26 Aug 2024.Downside capture measured over trailing 20 years ending 31 Jul 2024. **Representative indexes: quality:** MSCI USA Sector Neutral Quality Index; **dividend aristocrats:** S&P Dividend Aristocrats Index; **global infrastructure:** S&P Global Listed Infrastructure Index.

THE BOTTOM LINE: DIVERSIFY FUNDAMENTAL RISKS

Looking forward, our base case remains a soft-landing, but risk of a recession remains. Even if fundamentals are unaffected, this particular election is perceived as having added significance, heightening concern that a rare political event may influence markets.

Valuations and concentration are currently elevated, and U.S. equity market returns have historically been lower in periods following such peaks. Investors should ensure they are taking on different fundamental risks to achieve different outcomes.

For more information, please consult with your financial professional and visit nuveen.com.

Endnotes

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, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. Equity investments are subject to market risk or the risk that stocks will decline in response to such factors as adverse company news or industry developments or a general economic decline. Dividend yield is one component of performance and should not be the only consideration for investment. Dividends are not guaranteed and will fluctuate. Because infrastructure portfolios concentrate their investments in infrastructure-related securities, portfolios have greater exposure to adverse economic, regulatory, political, legal, and other changes affecting the issuers of such securities. Infrastructure-related businesses are subject to a variety of factors that may adversely affect their business or operations, including high interest costs in connection with capital construction programs, costs associated with environmental and other regulations, the effects of economic slowdown and surplus capacity, increased competition from other providers of services, uncertainties concerning the availability of fuel at reasonable prices, the effects of energy conservation policies and other factors. Additionally, infrastructure-related entities may be subject to regulation by various governmental authorities and may also be affected by governmental regulation of rates charged to customers, service interruption and/or legal challenges due to environmental, operational or other mishaps and the imposition of special tariffs and changes in tax laws, regulatory policies and accounting standards. There is also the risk that corruption may negatively affect publicly funded infrastructure projects, especially in emerging markets, resulting in delays and cost overruns. In addition, investing internationally presents certain risks not associated with investing solely in the U.S., such as currency fluctuation, political and economic change, social unrest, changes in government relations, differences in accounting and the lesser degree of accurate public information available, foreign company risk, market risk and correlation risk. This report should not be regarded by the recipients as a substitute for the exercise of their own judgment. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Nuveen, LLC provides investment solutions through its investment specialists.

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