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CIO Weekly Commentary
30 October 2023

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Real estate is yielding opportunities

Bottom line up top

Have the hawks finally subdued the doves? Nearly 40 years after Prince gifted music fans with an idea of what it sounds like when doves cry, financial markets are echoing that refrain. Late last week, the yield on the 10-year U.S. Treasury note eclipsed 5% in intraday trading — a level not breached since 2007. Though this threshold is largely psychological, many investors have been surprised by how quickly the 10-year yield has climbed since the end of July (Figure 1). The upward trajectory is the market's apparent acknowledgment that inflation and economic growth haven't retreated to levels that would persuade the U.S. Federal Reserve to pivot from its historically hawkish monetary policy. Nor is the Fed likely to do so anytime soon. However, the run-up in yields has done one job for the Fed, in the sense that financial conditions have tightened so much over the past two months that market expectations for a November rate hike have fallen to almost zero.

A rate reversal on the way? Not so fast. Investors insisting that policy rates will soon be lowered may want to rethink their forecasts. Although markets have seemingly concluded that the end of the Fed's rate-hiking cycle is already here, they also expect that the first rate cut of a new cycle to come by mid-2024 — a view we don't share. U.S. growth indicators — including labor market metrics and October's Purchasing Manager's Index (PMI), which exceeded expectations and remained in expansionary territory — still show fortitude in the economy. And while the Fed has made meaningful progress toward its 2% inflation target, both the economic data and the Fed's rhetoric continue to point

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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.

to higher-for-longer rates. That suggests yields will remain range-bound at elevated levels for now. Investors seeking attractive portfolio opportunities in this environment should consider allocations to risk assets — including commercial real estate — that historically have performed well amid similarly challenging circumstances.

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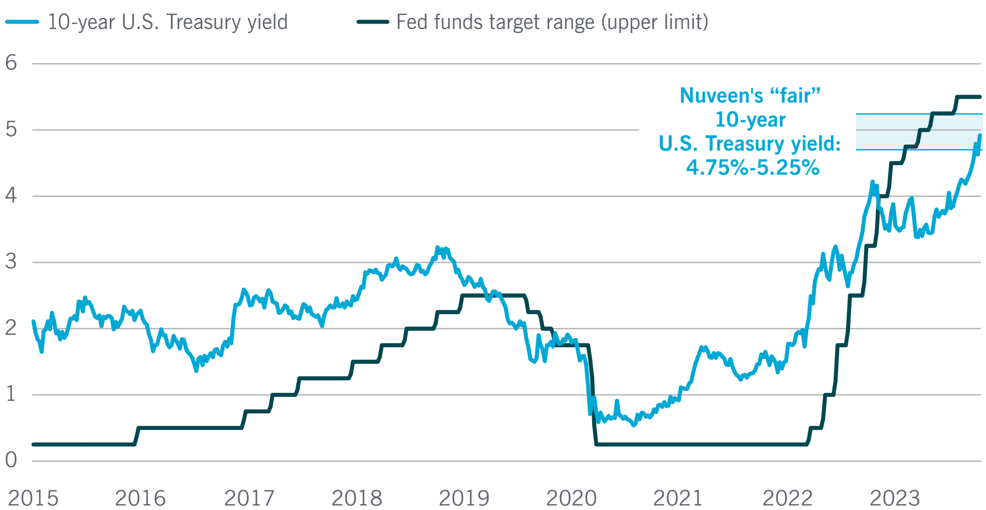
FIGURE 1: U.S. TREASURY YIELDS REFLECT NEW RATE EXPECTATIONS

10-year U.S. Treasury yield vs. fed funds target rate (%)



Data source: FactSet, Federal Reserve Bank of St. Louis, Nuveen, 20 Oct 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

Portfolio considerations

Commercial real estate has faced more than its fair share of headwinds since the beginning of the Fed's current cycle. From 16 Mar 2022 (the day the Fed raised rates for the first time in more than three years) through 26 Oct 2023, publicly listed U.S. real estate investment trusts (REITs) returned -25%, as measured by the FTSE Nareit All Equity REITS Index. In contrast, the broader S&P 500 Index fell -2.6% over the same period.

We believe negative sentiment toward REITs, and their underperformance, can be attributed largely to the market misunderstanding the impact of increased debt-financing costs on REIT earnings. In fact, REITs delivered better earnings growth in 2022 and in 2023 year-to-date than the S&P 500. Given their higher earnings growth and falling prices, REITs have seen their forward earnings multiple decline more than any other equity sector – making them attractive on a valuation basis.

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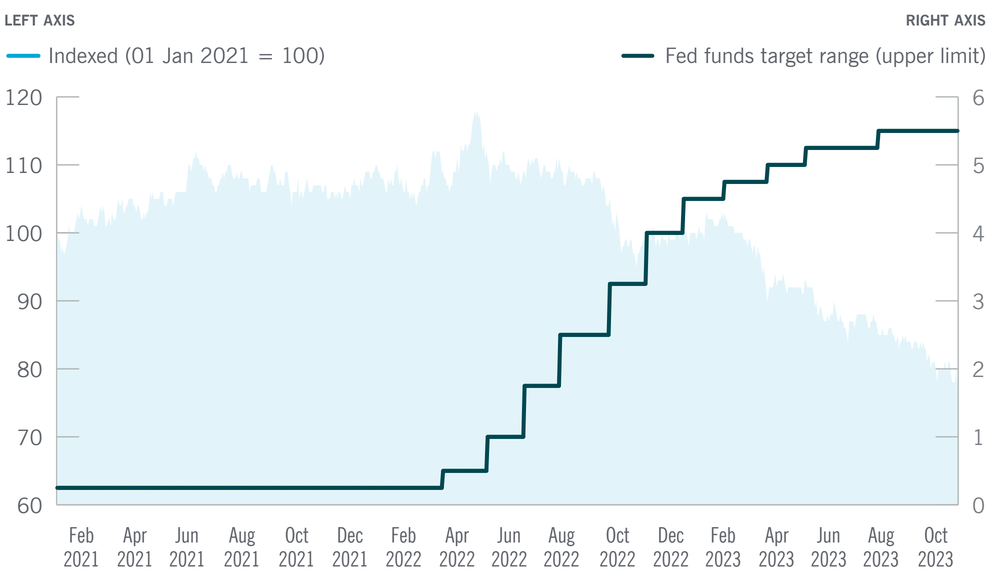
The velocity of rate hikes over the past 19 months has certainly been a formidable challenge. And doom-and-gloom headlines focused on the struggling U.S. office sector have also grabbed attention. But there's more to the REITs story. Most notably, REITs tend to outperform the broader equities market when the end of a Fed tightening cycle becomes more clearly imminent, as happened during the winding down of rate-hiking campaigns in 2006 and 2018. Those two periods in particular coincided with decelerating economic activity and a growing appreciation for the longer-duration cash flows that REITs offer. We believe REITs could follow this historical trend, as market expectations for peak rates are at recent highs, coinciding with cycle lows in terms of the underperformance of the asset class (Figure 2).

FIGURE 2: EXPECTATIONS FOR A PEAK FED FUNDS RATE COINCIDES WITH REITS CYCLE LOWS

Performance ratio of U.S. REITs Index vs. S&P 500



Data sources: Bloomberg L.P., 25 Oct 2023. **Performance data shown represents past performance and does not predict or guarantee future results.** The data presented here is for informational purposes only. Representative indexes: U.S. REIT Index: FTSE NAREIT All Equity Index.

Our highest conviction ideas in commercial real estate, both public and private, are also informed by key structural themes. An aging population, increased health care spending, issues with housing supply and affordability, and secular growth in multi-channel commerce are among the forces helping to create compelling real estate opportunities for retail and institutional investors alike. In light of these factors, incremental allocations to either public or private commercial real estate assets — or both — may be worthy of consideration.

We are currently more constructive on industrial, apartment and strip mall property types.

Regarding public REITs specifically, these equity securities tend to be forward-looking by nature. As a result, their near-term performance is likely to be driven by how — and at what cost — they're able to finance their businesses. Companies with ready access to capital and a variety of funding mechanisms available should be well positioned. Cost management will also be paramount, as an economic slowdown could potentially pressure top-line revenues. We are currently more constructive on industrial, apartment and strip mall property types. Conversely, sectors more closely tied to economic activity (such as office and lodging) and longer-duration assets that lack effective rent escalators (such as net-lease properties) currently look less attractive.

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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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. The real estate industry is greatly affected by economic downturns or by changes in real estate values, rents, property taxes, interest rates, tax treatment, regulations, or the legal structure of the REIT. Prices of equity securities may decline significantly over short or extended periods of time.

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