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CIO Weekly Commentary
28 October 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A vote to consider preferred securities

Bottom line up top

Positive earnings growth still requires concentration. At the end of last week, 75% of the S&P 500 Index companies reporting third quarter results so far have beaten consensus estimates. That's below the S&P 500's 5-year average of 77%, but in line with its 10-year average of 75%, according to FactSet. But while the U.S. equity market rally has broadened beyond mega cap technology names to encompass a more diverse range of sectors and companies, blended earnings growth (a combination of reported earnings and estimates for those yet to report) for the overall index remains highly concentrated: Removing just the four largest contributing companies would reduce the S&P 500's Q3 blended earnings growth rate from +3.4% to -0.1%. Estimates for all 11 index sectors improved modestly over the past week, however, a trend investors hope will continue. Between now and election day on 5 November, 213 companies, representing $25.7 trillion in market capitalization, are due to report.

The elephant (and the donkey) in the room. With the U.S. presidential election just eight days away, many investors continue to second-guess whether their portfolios are well-positioned for whatever lies ahead. We think it is critical to remain focused on long-term investment goals and attentive to the broader economic backdrop and company fundamentals, as election-driven volatility has historically been short-lived— even if the results of the election were not immediately known, as in 2000. With that in mind, corporate earnings, inflation and the direction of interest rates should continue to be the structural drivers of financial markets. This was evident in the recent backup in U.S. Treasury yields after they bottomed in mid-September

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On behalf of Nuveen's Global Investment Committee

As Head of Equities and Fixed Income, 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.

following the U.S. Federal Reserve's 50 basis points (bps) rate cut. Since then, the uptick in yields, paired with underlying fundamentals, may have created another attractive entry point for one of our favored fixed income sectors.

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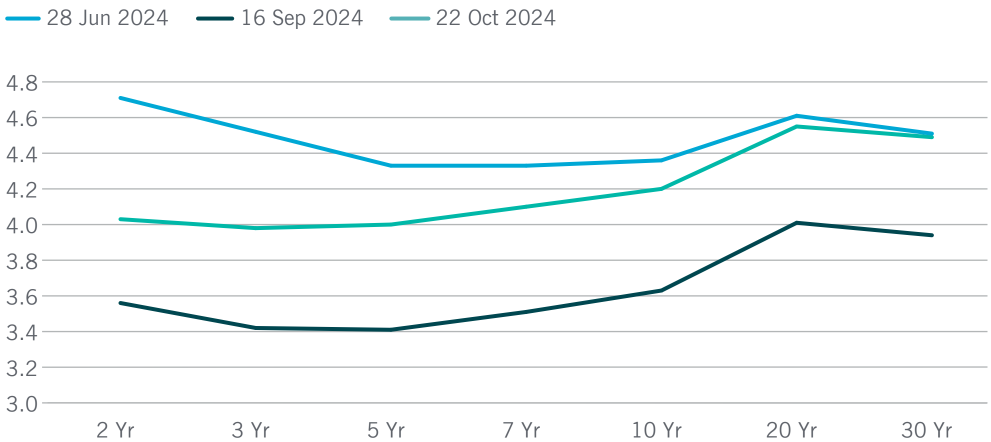
FIGURE 1: YIELDS HAVE REBOUNDED IN RECENT WEEKS

U.S. Treasury yields (%)



Data source: U.S. Department of Treasury, 23 Oct 2024. **Performance data shown represents past performance and does not predict or guarantee future results.**

Portfolio considerations

Preferred securities, an investment grade asset class, is among the top-performing fixed income sectors year-to-date, with a total return of +11.1% through 24 October (as measured by the ICE BofA All Capital Securities Index). This impressive gain has been driven by compelling yields, favorable supply/demand dynamics and strong bank earnings.

Among the different types of preferreds, we favor $1000 par securities, which are yielding 5.95% with a spread of 177 bps over U.S. Treasuries (Figure 2). Both $1000 par and contingent capital securities (CoCos) offer attractive levels of income relative to their duration risk.

Negative net supply for preferreds, specifically in the $25 par securities segment of the market, has resulted in a notable compression of option-adjusted spread (OAS) throughout the year. All else being equal, spread tightening drives price appreciation. In fact, $25 par securities now have a negative OAS. $1000 par securities haven't experienced the same level of spread compression, which creates a meaningful relative value opportunity over $25 par preferreds.

Banks, the largest issuer of preferred securities, have generally beaten consensus earnings estimates this reporting season. Earlier this year, annual stress test results demonstrated the continued strength of bank balance sheets, with robust capital ratios. And a recent Fed proposal would require banks to hold even more capital. Lastly, European banks, the largest issuer of CoCos, remain well-capitalized and can provide geographic diversification within preferred strategies.

Not all preferred strategies are created equal. Passively managed strategies allocate primarily to $25 par securities. In contrast, actively managed strategies often invest across the preferreds market, seeking to take advantage of opportunities as they arise. Additionally, active management can increase tax efficiency by intentionally allocating to securities that generate qualified dividend income. These securities are taxed at a maximum individual rate of 23.8%, rather than the higher federal income tax rate of 40.8%. Given uncertainty around future tax policy ahead of the U.S. election, we expect demand for tax-efficient strategies will remain high. An allocation to preferreds may warrant consideration within both taxable and tax-exempt portfolios.

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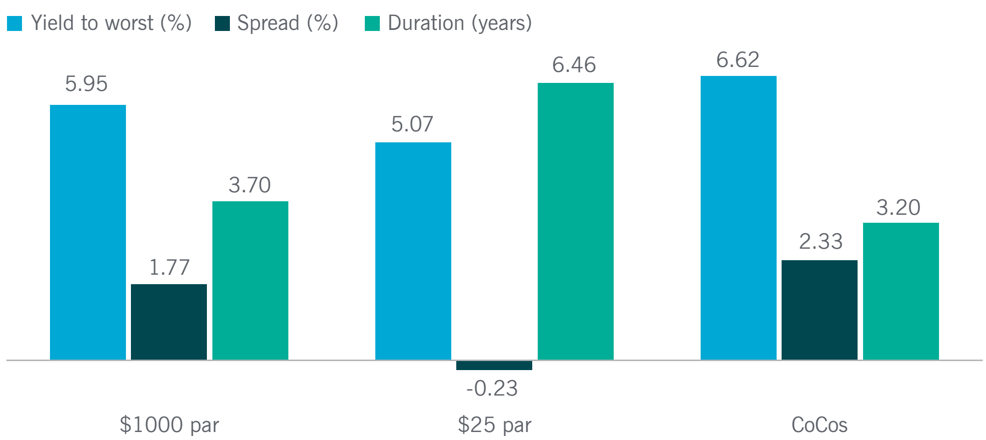
FIGURE 2: $1000 PAR AND COCOs STAND OUT FOR THEIR YIELD RELATIVE TO INTEREST RATE RISK

Characteristics of preferred securities



Data source: Nuveen, 18 Oct 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: $1000 par:** ICE BofA U.S. Inst Capital Securities Index; **$25 par:** ICE BofA Core + Fixed Rate Preferred TR Index; **CoCos:** ICE BofA USD Contingent Capital TR Index.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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 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.**

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