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Weekly Equities Commentary

15 November 2021

Hot inflation data cool equity markets

Hotter-than-expected inflation data took its toll on equity indexes within developed markets last week. Notably, the S&P 500 fell -0.3%, ending its streak of five weekly consecutive gains. The DJIA and tech-heavy NASDAQ fell -0.6% and -0.7%, respectively. The MSCI EM Index added 1.7%, largely due to a 3.5% gain in China, which was fueled by optimism over a potential softening tone regarding regulation. This, in turn, helped the ACWI ex USA rise 0.3% despite a loss of -0.3% for the EAFE Indexes.

KEY POINTS

- **Last week's modest pullback in U.S. equities may have been the result of overbought conditions, rather than fears of rampant inflation. The thesis for a bullish end to 2021 remains largely intact.**
- **The passage of a $1 trillion infrastructure bill had no immediate impact on equities, given extended valuations, but should be marginally positive for economic growth over the intermediate term.**
- **As earnings growth slows, investors are becoming more selective – choosing to reward (or punish) companies based on their earnings at a higher-than-average rate.**

Saira Malik, CFA
CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen as chair of the Equities Investment Council (EIC) and a member of Nuveen's Global Investment Committee (GIC). She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies, as well as portfolio management responsibilities for global equity strategies.

Market drivers & risks

- **October's Consumer Price Index (CPI) hit a 30-year high, but that doesn't mean an end to this bull market**.
  - The year-over-year CPI increase of 6.2% may seem alarming from a headline perspective, but equity markets took the number in stride. While prices have risen broadly, a deeper look reveals little change in the inflation pattern that has prevailed in 2021, with the highest levels of inflation concentrated mainly in areas of the economy most affected by temporary disruptions and distortions in supply/demand dynamics.
  - In October, for example, the overwhelming majority of price increases came from only a few baskets. And even if inflation ultimately settles above pre-pandemic rates, we share the Fed's view that these elevated levels will subside.
  - The worst of last Wednesday's market losses were within growth and technology stocks, given the sharp spike in long-term Treasury yields, while cyclicals and value outperformed. The S&P 500 pared its losses over the next two days, supporting our belief that the pullback was driven more by stretched valuations, rather than the beginning of a correction fueled by fears of inflation and diminished prospects for growth.
  - The thesis for a year-end rally remains largely intact thanks to several factors, including earnings growth, an accommodative fiscal environment and the reduced likelihood of increased corporate taxes.
- **The third-quarter earnings season essentially wrapped,** with a blended earnings growth rate approaching 40% — outpacing our top-end estimate of 35%.
  - Though we cheer earnings growth rates that top estimates, we are focused on how markets have reacted to both positive and negative earnings surprises. S&P 500 constituents with third quarter earnings that surprised to the upside (downside) have been rewarded (punished) at rates that exceed five-year averages. As expected, investors have grown more selective, favoring companies capable of defending and expanding margins by navigating supply chain disruptions and higher input costs – a trend we expect will persist.

> ***"The next few months could remain challenging, with continued high volatility and possible near-term market selloffs."***

Highlights from last week

- Results were evenly split for the S&P 500 from a sector perspective. Consumer discretionary was the hardest hit, falling -3.2%, with the heaviest losses coming from auto manufacturers. The energy sector lost -1.3% as the Biden administration made it publicly known that it was considering releasing strategic oil reserves to battle rising energy prices. Five sectors were in positive territory, lead by materials, which rose 2.6% thanks to the passing of the $1T infrastructure spending package last Monday.
- Last week investors received encouraging news related to global supply chains, as three of the world's largest automotive manufacturers indicated that their production levels are returning to normal. As one of the industries hardest hit by supply chain disruptions, automakers are now fueling optimism that the worst of the semiconductor chip shortage may be behind us.

Risks to our outlook

The Fed will be under intense scrutiny as it tiptoes toward contractionary policies. With markets so accustomed to quantitative easing and low rates, volatility is likely to rise as investors grow leery of a possible misstep in timing or magnitude.

Volatility may begin to spike toward the end of November, as the December 3 deadline for raising the U.S. debt ceiling may now coincide with finalizing a potential infrastructure spending package.

Though it appears as though U.S. corporate tax rate hikes may ultimately be avoided, investors must still assess the expected impacts of potential increases in other U.S. tax rates, including a minimum tax on U.S. companies' foreign income.

COVID-19 variants, such as the Delta subvariant discovered in the U.K., are likely to continue injecting volatility into global equity markets.

Best ideas

In the U.S., reflation and expectations for higher yields could bolster returns for small caps and financials, as well as companies with pricing power and reopening tailwinds. Supportive monetary policy and the prospect of stronger relative earnings growth could boost certain stocks in cyclically oriented sectors in developed non-U.S. markets, particularly in Europe and select emerging markets, ex-China. Select growth companies well positioned for reopening, such as front-office software leaders, also look attractive. Our long-term approach tilts toward cyclicals and value stocks that exhibit strong earnings growth and pricing power.

In focus

The new growth leader? You're up, Europe.

Our thesis for the transition of equity leadership from the U.S. remains intact, despite delays caused by the summer surge in the Delta variant. Although slow to start, this shift should gain traction amid accelerated vaccination rates and policy support, as well as the easing of global supply chain disruptions.

Heading into 2022, our optimism for the outperformance of non-U.S. equities, particularly European markets, has only increased. The pro-cyclical nature of the global economic recovery continues to favor Europe, given the composition of its stock market. The MSCI EAFE has higher weightings to industrials, financials and materials, and is underweight information technology relative to the S&P 500.

Additionally, the U.S. economic rebound from the COVID-19 recession quickly shifted from recovery to expansion, resulting in peak earnings growth in the second quarter of 2021, while the delayed recovery in Europe should allow for further earnings expansion in the quarters ahead.

Earnings results for the Stoxx Europe 600 Index in the third quarter rivaled those of the S&P 500 Index in the first quarter, with 68% of constituents surprising to the upside by the end of October, and earnings and revenue growth rates north of 50% and 13%, respectively. As earnings growth across the Atlantic continues to take hold in 2022, and with valuations trading at 15%+ discounts relative to their own history (and to the U.S. market), we see a very attractive entry point for European equities.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers, averaging three decades of investing experience. The EIC brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

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