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Weekly Equities Commentary

6 December 2021

Equities stalked by hawks, bears and Omicron

The spread of the newest COVID-19 variant, Omicron, resulted in a sell-off in developed equity markets last week. Among broad based indexes, the S&P 500 and tech-heavy NASDAQ lost 1.2% and 2.6%, respectively, while the DJIA lost roughly 1.0%. Abroad, the MSCI EAFE, EM and ACWI ex-USA indexes fell 1.0% and 0.7%, while the MSCI EM added 0.2%.

KEY POINTS

- **Anxiety driven by the Omicron COVID-19 variant has gripped equity markets since Thanksgiving, but we are optimistic that its impact on economic mobility will be little more than a speed bump.**
- **Although November headline payrolls disappointed, stronger underlying trends suggest employment data may accelerate heading into 2022.**
- **The Fed's recent rhetoric points to a more hawkish approach. In our view, the combination of an underwhelming jobs report and signs of decelerating inflation actually provides cover for continued patience.**

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

- **Omicron uncertainty drives volatility following Black Friday's market swoon,** as this new COVID-19 variant has now spread to nearly 40 countries.
  - Mindful of the risks that the pandemic poses to the global economy, we continue to monitor key metrics including hospitalizations and mortality – both of which have remained subdued during these very early days of Omicron. Amid decelerating economic growth, contractionary monetary policy and the rise of the Delta variant, growth stocks have outperformed. That said, each new variant has had a diminishing impact on mobility. We therefore think cyclicals could play catch up should virus fears subside, while economic growth normalizes and inflation settles.
- **Job creation once again fell short of expectations,** leaving economists wondering what will lead to a recovery in employment, and when.
  - While the addition of 210,000 jobs significantly missed most forecasts, a closer examination of the data provides a much more encouraging view. The household component of the survey, for example, indicated not only that 1.2 million more people were employed in November than in October, but also that roughly 500,000 individuals reentered the workforce. With the unemployment rate falling to 4.2% and weekly jobless claims remaining near multidecade lows, there are good reasons to be confident in an ongoing labor market recovery.
- **The Fed chose to adopt a more hawkish tone last week,** driving up expectations for faster tapering.
  - Even as U.S. Treasury yields and energy prices tumbled on fears of the unknown impacts of Omicron, expectations of accelerated contractionary policy reached new highs. Fed Chair Jerome Powell expressed a willingness to discuss an increased pace of tapering when the Fed meets in mid-December. Even with economic growth expected to reaccelerate, we have begun to see evidence of moderating inflation, which could ultimately leave room for the Fed to provide markets with a dovish rather than a hawkish surprise. A slower pace of rate increases would likely prove beneficial for equity markets.

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

Highlights from last week

- Concern over the new variant of COVID-19 took its toll on equity trading last week. From a sector perspective, the "bond-proxy" sectors, utilities and real estate, were the only two sectors in positive territory, adding 1.0% and 0.1%, respectively. Relative outperformers included consumer staples (-0.3%) and technology (-0.4%). The largest underperformers were communications services and consumer discretionary, each shedding more than 2.0% for the week.
- While we await more information on the virulence of Omicron, as well as the effectiveness of current treatments in combating this variant, last week's equity trading indicated a near-zero expectation for new economic restrictions, at least not in the U.S. In addition, President Biden indicated he has no plans for any federal shutdowns or lockdowns, and instead will focus on maximizing the number of Americans being tested and receiving booster shots.

Risks to our outlook

The full impact of the Omicron variant won't be apparent for some time, so we expect volatility to spike with each related headline. Although another COVID-19 wave had been anticipated, the fear of economic restrictions might weigh on global equity markets.

The Fed's hawkish stance has taken investors somewhat by surprise. With markets so accustomed to quantitative easing and low rates, volatility could rise as investors grow wary of a potential misstep in timing.

Once again, Congress managed to push back the deadline for raising the U.S. debt ceiling, this time until 18 February 2022. This means a longer wait before a potential "soft" infrastructure spending package is finalized.

Inflation will remain a sensitive subject for central banks and markets, as the notion of "transitory" has been eliminated from the recovery-era vernacular. The longer inflation rates remain elevated, the more skittish investors may become in fear of forced policy changes and downward pressure on future growth.

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

Fueling the energy sector

The energy sector has experienced a remarkable recovery from the depths of pandemic-driven economic lockdowns, returning approximately 50% year-to-date. Balance sheets have improved as demand for oil has strengthened through 2021. In fact, despite impacts from the mid-year spread of the Delta variant, demand has already returned to pre-COVID-19 levels. The trajectory for demand has remained so strong that the International Energy Agency (IEA) recently forecasted 2019 levels to be exceeded by the end of 2022.

While the advent of Omicron could potentially temper oil demand, this may prove to be temporary, as each new wave of the virus has had a smaller economic impact than the last. Meanwhile, OPEC+ announced last week its intentions to go forward with its planned increase of 400,000 barrels per day in January, even with the 20% drop in the price of crude caused by the newest variant. Additionally, we expect U.S. producers to exercise supply discipline in an effort to avoid price declines similar to that seen in previous cycles.

From a valuation perspective, we currently view the energy sector favorably, even after 2021's rally (a recovery rather than a boom). Even mounting sentiment against the sector — reflecting a shift in government and consumer focus away from fossil fuels to alternative/renewable sources — makes the sector attractive from a contrarian perspective. Assuming durability in oil price levels, along with strict adherence to production discipline, we believe energy can be a source of ample investment opportunity over the next several years.

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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Sources

All market data from Bloomberg, Morningstar and FactSet.

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GWP-1946023PR-W1221P