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CIO Weekly Commentary
16 May 2022

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Catalysts to quell volatility — what, how and when?

Bottom line up top:

Fear or fundamentals: what's driving volatility? As baseball legend Yogi Berra observed, "Ninety-nine percent of the game is half mental." Perhaps he'd have said something similar about investing in 2022, with sentiment, psychology and non-fundamental factors holding sway of late. Put buying, fund outflows, investor bearishness surveys and the S&P 500's failure to maintain key technical support levels all point to fear levels rising. Even as earnings growth has remained solid this year, stock prices have dropped sharply, pushing valuations significantly lower (Figure 1).

A room with a (medium-term bullish) view. Despite the technical noise, economic fundamentals remain generally sound, warranting guarded optimism about the medium-term outlook for markets. We expect recent turbulence to continue in the meantime, however. Greater clarity and further improvement in certain fundamental factors, if they materialize, are the likeliest potential catalysts for lowering market volatility.

- **Inflation**. April's 8.3% Consumer Price Index reading disappointed investors hoping and expecting inflation to cool more. Instead, it plateaued, driven by steep increases in airfares, hotel rates, rents and durable goods. But some underlying details — falling used car prices, less spending on goods and signs of easing supply chains — offer hope for more meaningful relief in May.
- **The Fed**. May's CPI report is due before the next FOMC meeting in June, so there's another chance policymakers could see a degree of inflation moderation that's been elusive thus far. Markets are likely to welcome any evidence of decelerating inflation or data showing

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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.

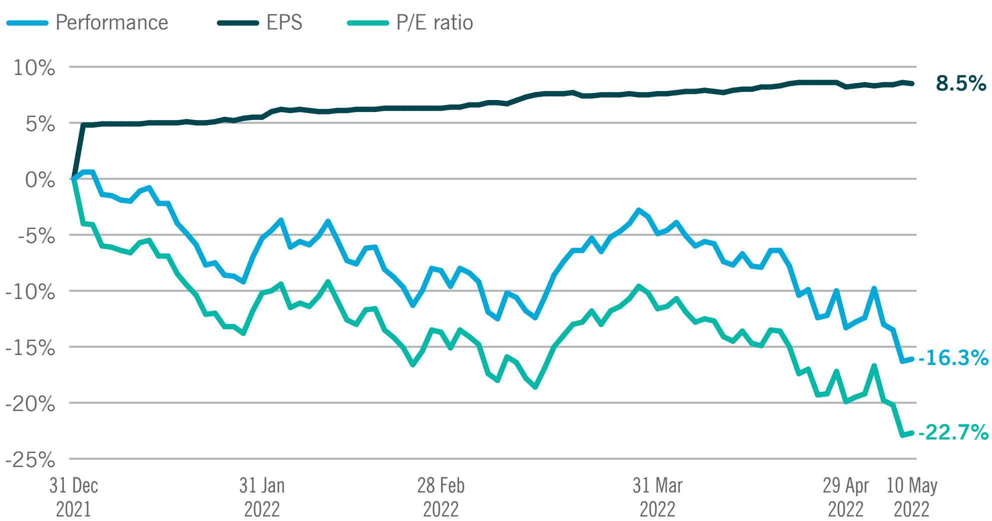
that high prices, constrained supply and rising interest rates are leading to demand destruction, but the Fed would need to see more than one month's worth of data before it considers tempering its tightening.

- **Jobs and consumers**. Reduced personal consumption could help bring inflation down in the near term, yet consumer spending drives demand over the long run. What might a balance of these objectives look like? More workers employed in growing areas of the economy where job creation is strong and the demand for labor is not so excessive as to trigger a wage/price spiral. This is the environment we currently see in the manufacturing sector, where PMIs remain firmly expansionary and April marked the 12th consecutive month of job gains, yet increases in average hourly earnings have been moderate.

Volatility may remain elevated, but we're looking for fundamental signals that could point to more market stability.

FIGURE 1: LOOKS LIKE THE DOWNTURN IS MORE FEAR THAN FUNDAMENTALS

Changes in the S&P 500 Index performance, earnings-per share and P/E ratio



Data source: Bloomberg, L.P., 31 Dec 2021 to 10 May 2022. Based on 12-month forward price-to-earnings ratios and earnings-per share. **Past performance does not predict or guarantee future results.**

Portfolio considerations

Within **equities**, we prefer a defensive tilt toward **dividend growers**. Historically they have outperformed the broader U.S. equity market during Fed rate hiking cycles (Figure 2) and in periods of heightened volatility.

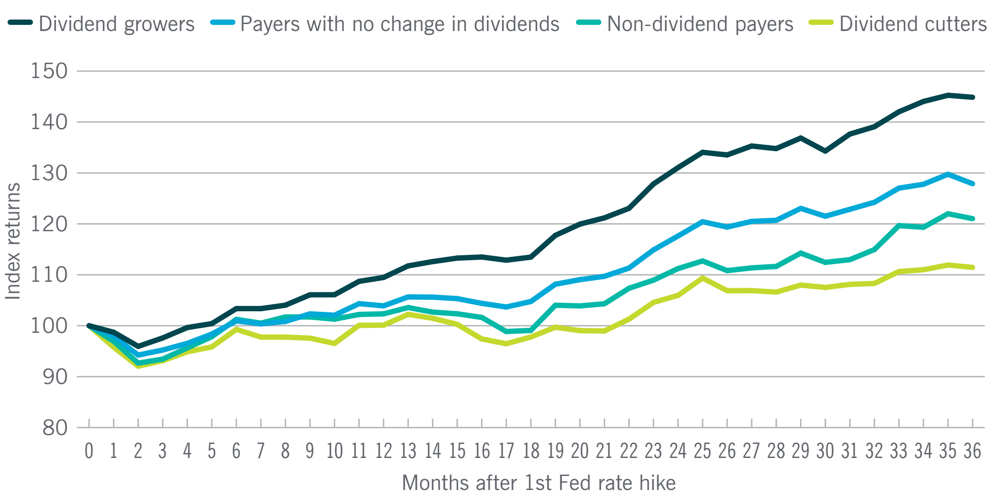
As we've seen throughout 2022, duration assets have failed to provide a cushion against risk-off market declines. But we think it's **still too early to increase exposure to interest-rate sensitivity**, as the Fed has only recently embarked on its hiking cycle. Additionally, in periods of higher inflation, core bonds have typically struggled to generate real returns. Within **credit**, yields have improved substantially. **High yield** is once again high yielding at around 7.5%, and spreads are relatively attractive versus history. And while the recent widening reflects increased perceived risks in the economy, it also offers a potential buying opportunity (and a yield cushion if markets sour further). Overall, we see strong fundamentals across corporate sectors, but **in the below-investment grade space** we believe it's **prudent to stay up-in-quality (BBs)**.

Tax-sensitive investors can still take advantage of dislocations in the **municipal bond** market. At the front end of the muni curve, yields are the highest they've been in years, and at the long end, muni/Treasury ratios exceed 100%.

We're focusing on areas of the market that offer better relative value and/or opportunities that could protect against volatility.

FIGURE 2: DIVIDEND GROWERS COULD BENEFIT IN THE MEDIUM TERM

S&P 500 Index performance after Federal Reserve rate hikes



Data source: Ned Davis Research Inc. and Refinitiv. Copyright 2022 © Ned Davis Research, Inc. **Past performance does not predict or guarantee future results.** Data based on the average performance after all rate hikes since 1973, which occurred on 31 Aug 1977, 30 Sep 1980, 31 Mar 1984, 31 Aug 1987, 31 Jan 1994, 31 Mar 1997, 30 Jun 1999, 30 Jun 2004 and 31 Dec 2015. The performance of each group is based on the equal-weighted geometric average of dividend-paying and non-dividend-paying historical S&P 500 stocks, rebalanced monthly. Each stock's dividend policy is determined on a rolling 12-month basis. For example, a stock is classified as dividend-paying if it paid a cash dividend at any time during the previous 12 months. A stock is reclassified only if its dividend payments change. Dividend growers and initiators include stocks that raised their existing dividend or initiated a new dividend during the preceding 12 months. Dividend cutters or eliminators include stocks that lowered their existing dividend or stopped paying regular dividends during the preceding 12 months. It is not possible to invest in an index.

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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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