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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

The tide has yet to turn for non-U.S. equities

Bottom line up top:

Today's ultra-cheap non-U.S. equity valuations may be alluring, but beware the impulse to jump right in. For some investors, this may be easier said than done, bringing to mind Oscar Wilde's famous quip, "I can resist everything except temptation." Yet resistance to temptation is exactly what's called for when assessing non-U.S. stocks based on their current equity risk premiums (Figure 1). Their bargain-bin levels may represent value traps rather than true long-term value.

A conspicuous lack of positive catalysts is the main source of concern. Across regions, we see far more headwinds than tailwinds to justify establishing or adding to non-U.S. equity allocations.

- **Europe.** The energy crisis and war in Ukraine are the most obvious disruptors of economic activity. Germany has nationalized a major power company and plans to ration energy to stretch reserves, which will limit industrial output. Additionally, the European Central Bank has just started raising rates, putting it far behind both the Bank of England and the U.S. Federal Reserve, especially after another aggressive U.S. hike last week (Figure 2). These factors outweigh the positives of bolstered energy reserves and fiscal stimulus. Stimulus will help consumers but likely exacerbate inflation, which is on the rise and not expected to ease any time soon.

  Developments that could help turn the tide: A de-escalation of the war, new sources of energy being brought online and the possibility of a milder-than-expected winter.

Saira Malik, CFA
Chief Investment Officer

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.

- **Japan.** The Bank of Japan (BoJ) reaffirmed its outlier dove status among central banks last week through its yield curve control policy. It purchased ¥2 trillion of bonds to put a ceiling on rates and bring liquidity to the benchmark 10-year government bond, which had recently gone untraded for two days. Yield curve control has driven the yen sharply lower, adding inflationary pressure in a country that needs to import many basics like food and energy. To counter the yen's precipitous drop, last Thursday Japan intervened to prop up its currency for the first time in 24 years.

  Developments that could help turn the tide: A move toward policy normalization within Japan. Separately, diminished U.S. inflation and less aggressive Fed hikes would likely take some pressure off the BoJ.

- **China and other emerging markets.** China, the largest EM and the world's second-largest economy overall, is perpetuating its untenable zero-Covid policy, dragging down both domestic growth and contributions to the global economic recovery. The continued potential for major production zones such as Shanghai to be shut down adds to uncertainty and the risk of further economic pain.

  Developments that could help turn the tide: More clarity on China's policy intentions and evidence of economic progress. Elsewhere in EM, nascent bright spots in Latin America, notably Brazil (which sends nearly half of its crude oil exports to China), could foster confidence in that region's valuations.

We see far more headwinds than tailwinds to justify establishing or adding to non-U.S. equity allocations.

FIGURE 1: CURRENT EQUITY RISK PREMIUMS MAY JUST BE VALUE TRAPS

Equity risk premiums for U.S. and non-U.S. equities

	U.S. equities	European equities	Japanese equities	Chinese equities
Equity risk premium	4.74	9.44	8.83	7.13
3Y avg. spread	5.28	7.84	6.73	5.19
5Y avg. spread	5.20	7.96	7.24	5.63
10Y avg. spread	5.51	7.64	7.29	6.69
3Y Z-score	-1.40	1.31	1.51	1.23
5Y Z-score	-1.21	1.48	1.22	1.05
10Y Z-score	-1.00	2.06	1.51	0.26

Spreads tighter than historic average — Spreads wider than historic average

Data source: Bloomberg L.P., 22 Sep 2022. Equity risk premium refers to the excess returns over U.S. Treasuries. **Past performance does not predict or guarantee future results. Representative indexes: U.S. equities:** S&P 500 Index; **European equities:** MSCI Europe Index; **Japanese equities**: MSCI Japan Index; **Chinese equities:** MSCI China Index. Z-score is the number of standard deviations between the current spread level and the average spread. Equity risk premium refers to the excess returns over U.S. Treasuries.

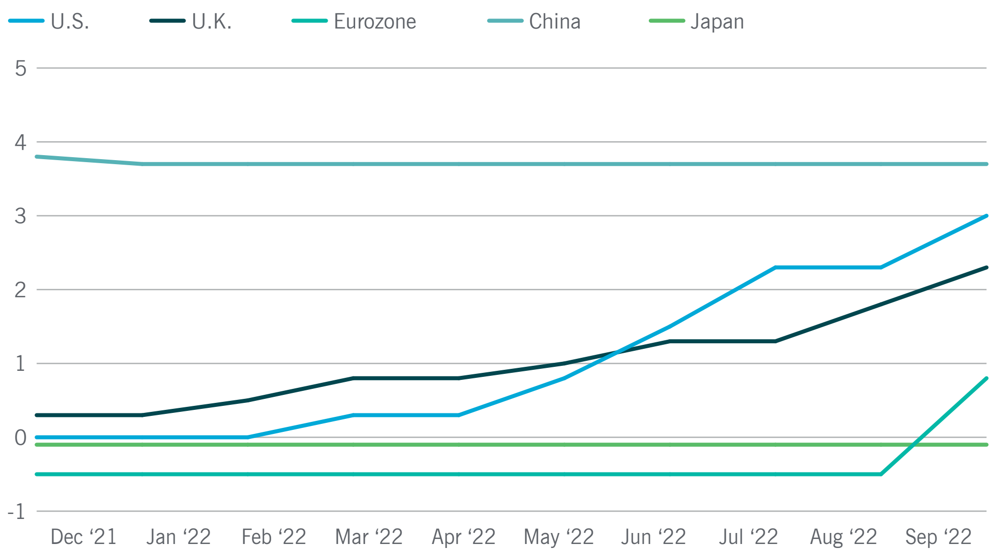
OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

Portfolio considerations

For now, we advocate underweighting non-U.S. equities as part of a strategic asset allocation, due to the lack of positive catalysts in key markets. At the same time, we will continue to monitor all markets with the conviction that compelling absolute and relative value opportunities, and not just value traps, will eventually present themselves and warrant serious investment consideration.

FIGURE 2: JAPAN AND EUROZONE POLICY RATES LAG U.S. AND U.K.

Central bank policy rates (%)



Data source: Bloomberg L.P., 22 Sep 2022.

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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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Important information on risk

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. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as “high yield” or “junk” bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. 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. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don’t use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. 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.

Nuveen provides investment advisory services through its investment specialists.

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