

Viewpoints from the Global Investment Committee

Q2 | 2023 OUTLOOK

Caught in a holding pattern

KEY TAKEAWAYS

1

Investors are unnerved by a combination of banking sector turmoil, inflation pressures and an uncertain interest rate environment.

2

Until more clarity emerges, **we expect markets will be in for a bumpy ride.**

3

Our investment themes focus on **preparing for an economic slowdown, capitalizing on shifting market values and balancing risks across public and private markets.**



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OPINION PIECE. PLEASE SEE IMPORTANT
DISCLOSURES IN THE ENDNOTES.

Caught in a holding pattern



Saira Malik

Chief Investment Officer

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.

Our 2023 year-ahead outlook forecasted terrain that would be difficult to cross: persistent inflation pressures, moderating interest rate hikes, slowing economic growth and a likely recession. We titled that outlook *Peaks and valleys: Navigating the rocky market landscape*, acknowledging the easing of some risks and the rise of others.

In the early weeks of 2023, a disinflationary trend took hold, fueling a market rally and optimism for an impending pause in rate hikes. Volatility surged in March, however, following the failure of Silicon Valley Bank and perceived instability of the U.S. banking system. Should that instability continue, it could complicate the Fed's ability to promote financial stability and measured inflation, adding yet another element of uncertainty to the outlook. Regardless, we seem to be already in that "higher-for-longer" interest rate environment, which is likely to trigger slower growth, make life more difficult for consumers and cause tighter liquidity conditions, all of which have portfolio construction implications.

Given the complicated economic and market backdrop, investors are facing a difficult journey. Unfortunately, we don't expect a smooth ride given that several risks still loom large. While the interest rate outlook remains uncertain, the post-GFC world of ultra-low rates is clearly behind us. Inflation remains elevated. And we expect the global economy will slow. In other words, investors are caught in a holding pattern until we get more clarity around the direction of rates, inflation and growth.

So what should investors do during this holding pattern? We unraveled that conundrum in our most recent Global Investment Committee sessions. And our conclusions lead us to offer the following three portfolio construction themes:

Prepare for landing. We anticipate a mild recession, which leads us to argue for primarily defensive positioning. Visibility remains low, and the GIC suggests preparing for a bumpy ride beyond 2023 as the Fed remains in "wait and see" mode. Ultimately, the landing will be determined by when inflation is finally anchored and how quickly the associated downside risks are mitigated.

Don't put your portfolio on autopilot. Some areas might make sense to pare back (such as investment grade taxable fixed income) and other areas may warrant leaning in (like emerging markets equities). In other words, a holding pattern doesn't mean investors can take their hands off the proverbial controls. Markets have moved noticeably over the last several months, causing relative values to shift within and between different asset classes.

Balance the public/private predicament. This important theme from 2022 remains in focus, as many expect and fear that the public markets selloff from last year will work its way into private markets. We see some technical pressures in areas of private real estate, for example. But we also see areas of the private investment space that remain attractive, such as private credit.

Our updated asset class heat map and our asset class "best ideas" outlooks show how these themes specifically play out and outline the advice we're offering to our clients. Overall, though, while we await clearance to land, we expect more turbulence and volatility. And at the risk of stretching this metaphor past its breaking point, we suggest buckling your seatbelts and expecting a bumpy ride.

Portfolio construction themes

Our portfolio construction themes center on acknowledging that downside risks to the economy remain, capitalizing on shifts in market valuations, and balancing risks across and between public and private markets. While growth remains solid (for now), we do seem to be in the “higher-for-longer” interest rate environment and inflation remains a concern. This perpetuates what has been a tricky investment environment.

Asset class “heat map”

Our cross-asset class views indicate where we see the best relative opportunities within global financial markets. These are not intended to represent a specific portfolio, but rather to answer the question: “What are our highest conviction views when it comes to putting new money to work?” These views assume a U.S. dollar-based investor seeking long-term growth and represent a one-year time horizon.



The views above are for informational purposes only, and compare the relative merits of each asset class based on the collective assessment of Nuveen’s Global Investment Committee. They do not reflect the experience of any Nuveen product or service. Upgrades and downgrades reflect quarterly shifts in these views.

Portfolio themes

- **Prepare for landing:** We still think it makes sense to be selective with cyclical and continue playing defense in diversified portfolios. Given downside risks, we expect to see a mild recession either this year or next.

This leads us to emphasize dividend-paying equities (for their more defensive and income-generating characteristics) as well as infrastructure investments that can weather a combination of slowing economic growth and volatile interest rates. Additionally, we have a common preference for relatively higher quality investments across asset classes (including fixed income, private equity and real assets).

- **Don't put your portfolio on autopilot:** Now may be a good time to consider taking profits in some areas and adding to risk in others. Many public market valuations have shifted noticeably since we published our year-ahead outlook in December. And cross-asset risk profiles have evolved as well.

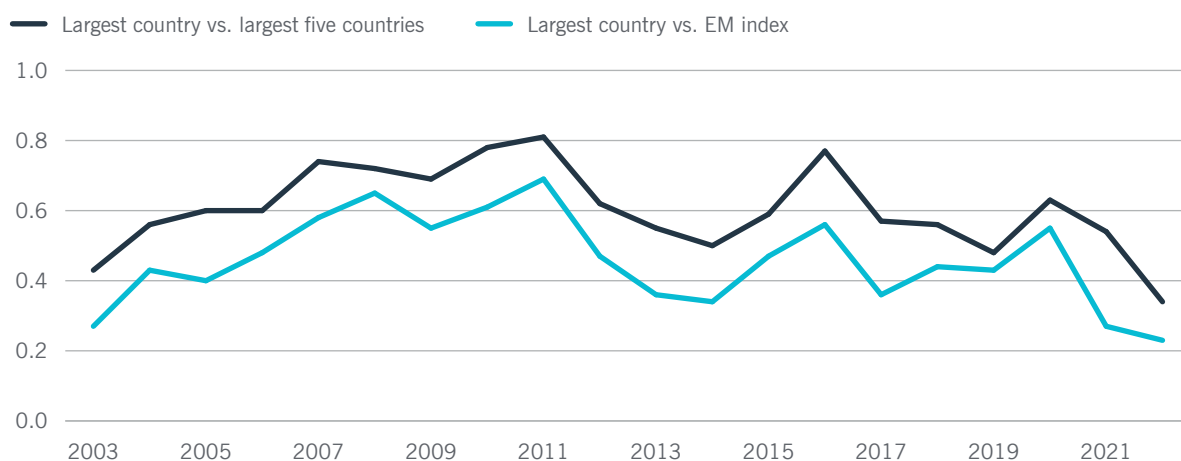
In the former category, we would point to areas such as investment grade fixed income, public REITs and investment grade municipal bonds.

We continue to believe these areas offer compelling fundamentals, but all three have enjoyed strong rallies that have made valuations less compelling than they were a few months ago. In the latter category, we're seeing opportunities to add some risk and beta to portfolios by focusing on emerging markets (particularly emerging markets equities). We also continue to like high yield municipals.

- **Balance the public/private predicament:** Many investors fear that last year's sharp selloff in public markets is still going to come due for slower-acting private markets. And some are concerned that they may be overweight in private assets due to pricing imbalances.

From our vantage point, we do see technical risks, such as in some areas of private real estate. And we also anticipate near-term deal flow hurdles in areas such as private equity. And the failure of Silicon Valley Bank highlights the importance of dependable financing sources. But other areas within private markets look quite compelling. We'd point to private credit (particularly middle market loans) given that private credit investments typically focus on more defensive sectors and that deal structures look solid.

Figure 1: Selectivity matters in emerging markets as correlations are falling



Data source: Bloomberg, L.P., 01 Jan 2003 to 31 Dec 2022. Performance data shown represents past performance and does not predict or guarantee future results. Data depicts the annual correlations between countries represented in the MSCI Emerging Markets Index. The largest constituent varies over time (South Korea between 2003 and 2007; Brazil in 2008 and China from 2009 to the present).

Significant changes in our views

- **Value is emerging in emerging markets:**

Amid an overall preference for less cyclical and more defensive positioning, we think it makes sense to balance this stance by taking a closer look at emerging markets. A key catalyst for this change is a better environment in China. That country is seeing improved economic growth, thanks largely to a significant policy turnaround with the end of its zero-Covid stance.

Both emerging markets equity and debt investments offer more attractive valuations than they did a few months ago, and U.S. dollar strength is less of a headwind. EME investments in particular should benefit from a flexible and active approach, as correlations between countries continue to fall (Figure 1). In addition to favoring China, we also see good relative value in Mexico, Brazil and Indonesia.

- **Diversify credit risk exposures:** We believe bond yields will moderate and gradually fall over the course of 2023. Across taxable fixed income markets, we think better opportunities exist by taking on credit risk rather than duration risk (although we still favor higher duration in municipals where ongoing inflows should support the longer end of the curve).

We see value across credit sectors, especially in high yield and loans, and would emphasize that we generally favor relatively higher quality segments within individual credit sectors. We also have a favorable view toward preferred

securities. Although recent banking sector turmoil has weighed on the issuer base, it has also made valuations more attractive. Barring much more extensive financial sector contagion than we expect, we continue to see select areas of value in this space.

Our highest-conviction views

- **Infrastructure (+)** remains a particularly favored area for us. While inflation appears to be easing, it remains a risk. Infrastructure investments (such as regulated utilities) are usually able to pass along higher costs to consumers. At the same time, infrastructure is an asset class that tends to be resilient in the face of slowing economic growth. We have a modest preference for listed over private infrastructure, as the latter may still experience some “price lag” effects as privates catch up to what happened to public markets last year.
- **Private credit (+)** fundamentals remain sound. These investments tend to be focused on more resilient areas of the market such as health care, software and insurance brokers that are relatively well positioned to withstand economic downturns. The strong price appreciation across public fixed income markets since the end of last year also makes private credit relatively more attractive.
- **Treasuries (-)** offer higher current yields than they did a year ago, but, simply put, we see much better places to put cash to work.



It may be a good time to consider taking profits in some areas and adding to risk in others.

The economy and markets

Key points to know

For global economic growth, it's better to be lucky than good.

In our 2023 outlook, we cited weather as a source of global economic uncertainty. And the unusually warm winter in North America and Europe removed a significant amount of downside risk from the economic landscape. Consumers saved on energy costs, allowing them to spend more elsewhere, and headline inflation declined faster than expected. China, proving that idiosyncratic risk is not always negative, lifted its Covid restrictions, raising the potential that a strong rebound in household spending will lift Chinese output this year and contribute to additional global growth in the coming quarters.

Banking concerns vs. strong data

March's U.S. bank failures have led investors to lower their outlook for policy rate increases over the balance of the year. But should this panic prove short-lived thanks to the swift and aggressive response from regulators, interest rates may rise again as economic data remains strong (Figure 2). Global consumers look resilient, as real income growth turns positive once more. Labor markets remain as tight as ever, and central banks continue to voice concern that this could lead to persistent inflation in service industries. Surprisingly strong growth brings with it the risk that inflation will fail to moderate without further policy tightening.

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The “higher-for-longer” interest rate environment may already be here, which should spark ongoing volatility.



Just when you thought 2022 was over.

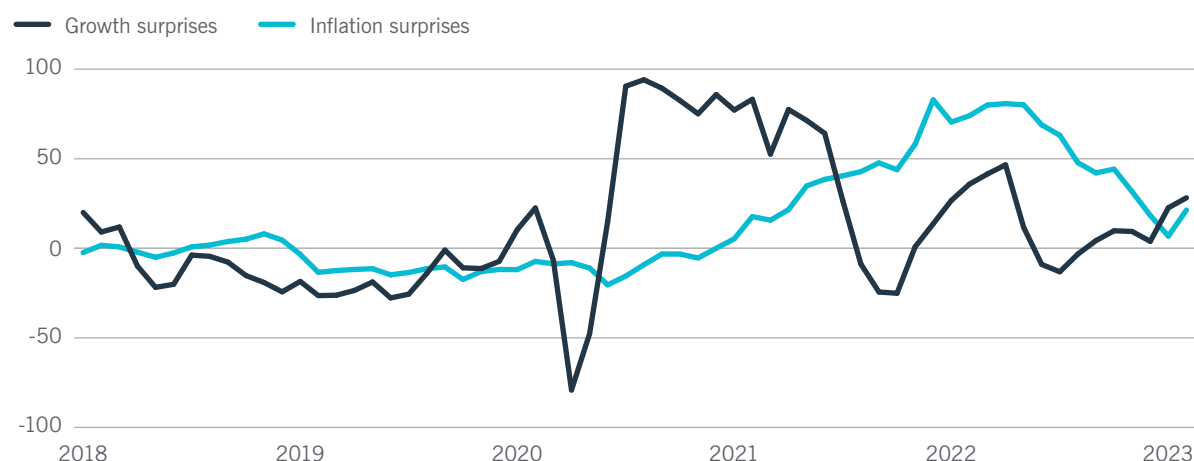
Investors don't have to go back very far to recall a market environment driven primarily by fears of rising interest rates and high inflation. Few of us would like to repeat the 2022 experience. But until we see confirmation that growth and inflation are slowing, central banks will remain biased toward raising interest rates, making it difficult for either equity or fixed income markets to sustain the rallies that began back in November (let alone build on them). At the same time, we are not convinced the extremely strong economic opening to 2023 will hold in the coming months, meaning rates may not have too much higher to climb and a full-on repeat of last year remains a downside risk case, not our base case.

Brace for a bumpy final descent.

Investors came into the year pricing in a rapid decline in inflation without much pain in the labor markets. Central bankers have probably secretly been hoping for the same outcome. But we think this perfect ending is too good to come true. Instead, we expect slow but resilient growth and a slow but steady decline in core inflation. Much of that decline will come at the expense of corporate profit margins, leading more companies to consider layoffs as their stocks struggle. At the same time, we continue to see a number of compelling investment opportunities. Assets like high yield credit and loans, which rely on economic growth without being too sensitive to higher rates, are among our preferred asset classes.

Figure 2: Growth is surprising on the upside, inflation less so

Citi Global Economic Surprise and Global Inflation Surprise Indexes



Data source: Bloomberg, L.P., 01 Jan 2018 to 28 Feb 2023. Performance data shown represents past performance and does not predict or guarantee future results.



EQUITIES

Saira Malik

Investment positioning

- The 2022 headwinds that punished equities (persistent inflation, rising rates, geopolitical turmoil and recession fears) remain a force, but continue to shift and vary in magnitude. Investors have grown increasingly resigned to a fate of “higher-for-longer” interest rates — a theme central banks have been expressing for several quarters. We anticipate continued volatility and uncertainty, and this mixed environment leads us to favor a barbell approach when it comes to equity risk allocations.
- We prefer an overall defensive stance across global equity markets, and favor investments with solid free cash flow, enough pricing power to help offset inflation and those with the ability to grow dividends while remaining predominantly agnostic of style, market cap or sector. Select industries, such as semiconductors and software, may be well suited for this unique environment given a degree of demand inelasticity and their historical ability to operate with tight margins.
- To balance this positioning, we would look to emerging markets equities as an attractive option to take on more risk and gain some beta exposure. A weaker U.S. dollar, attractive valuations, improving earnings estimates and the reopening of China should all provide tailwinds.
- Even before recent events, we were wary of the banking industry, and still expect additional volatility. We see select opportunities in some financials (particularly large, globally diversified companies), but remain cautious toward the sector as a whole.
- Global small caps appear undervalued and are beneficiaries of easing inflationary pressures. While experience demonstrates the asset class’s propensity to underperform heading into an economic slowdown, small caps are typically among the earliest areas of the stock market to recover from an economic downturn.

BEST IDEAS: *Dividend-growers tend to be high quality companies with strong free cash flow levels and offer the added benefits of income generation and lower relative volatility compared to the broader market.*



FIXED INCOME

Anders Persson

Investment positioning

- Despite the banking turmoil, conditions have improved for fixed income markets since the end of last year: credit fundamentals look healthy, inflation is moderating and global economic growth remains solid. Valuations have adjusted considerably and are now closer to fair value levels, though medium-to-longer-term income generation opportunities still appear robust.
- Our key investment themes are to emphasize credit risk over duration risk and to focus on flexibility and diversification across credit sectors versus over- or under-allocating to any one area.
- Within that context, however, we recognize that investment grade fixed income has had a strong run. While we continue to see pockets of opportunity, that area of the market as a whole appears fully valued.
- Across other areas of the market, we are slightly more positive toward emerging markets debt as economic stability increases. We also think senior loans offer compelling yields and we continue to see value in high yield bonds — especially in the higher credit quality areas. Additionally, we like select names in preferred securities thanks to attractive valuations.

BEST IDEAS: *With credit spreads potentially vulnerable in the near term, our highest conviction views are to focus on mid- to high quality areas of the high yield and loans markets, as well as on preferred securities.*



MUNICIPALS

John Miller

Investment positioning

- The sharp and painful decline across municipal bonds finally turned the corner at the end of 2022. The asset class has since enjoyed a strong snapback, and investor inflows returned with a vengeance. In retrospect, the selloff was clearly based more on sentiment and technicals (e.g., inflation fears and rising rates) than fundamentals. Nevertheless, investors should expect ongoing volatility in municipal markets.

- We see continued value in taking on some duration risk in municipal bonds. Fundamentals remain sound and credit quality looks healthy. Given the strong January rally in municipals, some relative value has been taken out of the market, particularly on the investment grade side within short to intermediate maturity ranges.
- At present, we're seeing the best value in lower coupon (around 3%), longer duration, high quality municipal bonds backed by essential service sectors. These areas of the market offer attractive yields, relatively wider credit spreads and appear very well positioned to withstand a recession or economic slowdown.

BEST IDEAS: *In the investment grade space, we see the best opportunities in select longer duration, high quality bonds that continue to offer value. The high yield area offers a number of idiosyncratic opportunities in areas such as specialty transportation.*



REAL ESTATE

Carly Tripp

Investment positioning

- While property-level fundamentals remain strong within the areas of our primary focus (housing, industrial and alternatives), private real estate markets continue to experience headwinds associated with macroeconomic volatility and uncertainty. As a result, deal activity remains subdued and access to liquidity is limited. While we are seeing some market activity return, many investors expect private real estate valuations to lag public markets, which have returned a portion of the losses experienced in 2022.
- In this environment, we continue to favor real estate debt over equity, as yields today are higher than cap rates in many circumstances. Within this area, we prefer structured and high-yield debt investments.
- We also continue to see idiosyncratic opportunities across geographies: in the U.S., we like specialized medical offices that benefit from aging demographics and an increasing move toward outpatient procedures; we favor European suburban housing (specifically rentals) in areas enjoying growing industrialization; and in Asia we prefer investments such as Tokyo senior living facilities and Australian student housing benefiting from demographic trends.

BEST IDEAS: *In addition to the above, we remain focused on “global cities” experiencing growing, educated and diverse populations with a particular focus on the health care, industrial and housing sectors.*

REAL ASSETS



Justin
Ourso



Jay
Rosenberg

Investment positioning

- Heading into 2023, we emphasized opportunities in public infrastructure investments as an area that could perform well when interest rates rise and economic growth slows. The investment thesis for listed infrastructure still holds. We particularly favor U.S. regulated utilities and waste companies, and see risks abating somewhat across European infrastructure, particularly in utilities and transportation.
- Public real estate markets faced notable underperformance in 2022 and look attractive. We see solid opportunities in the asset class, particularly in the industrial, strip retail and select net lease segments. We are less favorable toward the office sector, which continues to struggle.
- Private infrastructure investments should benefit from many of the same trends that their public counterparts enjoy. We emphasize investments that benefit from the continuing global energy transition from fossil fuels to electrification and clean energy generation.
- Across other private real assets, we see value in agribusiness companies, particularly those focused on protein sectors and food ingredients for both human and pet food consumption, and also favor timberland investments that should benefit from increased housing demand. We continue to like farmland investments (especially row crops), but we expect the pace of farmland price appreciation to slow from the elevated levels seen in 2021 and 2022.

BEST IDEAS: *In public markets, our best ideas include industrial real estate and investments that should benefit from improved Chinese economic growth and reopening, such as Hong Kong real estate. We also favor defensive investments such as regulated utilities and waste companies. In private markets, we continue to focus on investments that align with climate transition, such as clean energy, renewable fuel sources and continued strong global demand for protein and healthy foods.*

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. Quarterly 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.

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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