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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

The case for allocating to higher-yielding assets

Bottom line up top

The latest on inflation: Less heat. But also little chance of lighting a fire under the Fed. Last week's release of January's Personal Consumption Expenditures (PCE) Index helped smooth some recent financial market volatility driven by a trend of reaccelerating inflation. Headline PCE rose 0.3% for the month of January and 2.4% year-over-year, while the corresponding increases for core PCE — which excludes the volatile food and energy components and is the Federal Reserve's preferred inflation barometer — were 0.4% and 2.8%. That 2.8% figure marked the lowest year-over-year increase in the core PCE rate since March 2021. Markets were further assuaged by a sharp downward revision in December's PCE.

But while investor concerns about a winter warm-up in inflation may have eased, wage growth and higher costs for services and housing remain among the biggest culprits of "sticky" inflation and will likely stay the Fed's hand in terms of near-term rate cuts (Figure 1). With rates steady and a better-than-expected corporate earnings season now behind us, stock markets may find it hard to spot their next catalyst in the coming few months. This backdrop may serve as a good prompt to consider allocating to higher-yielding areas of the fixed income market.

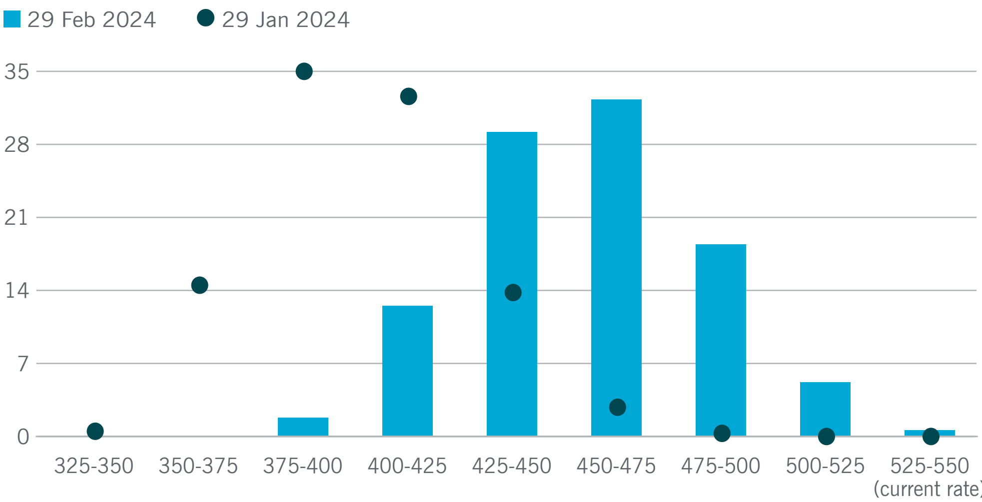
Saira Malik, CFA
Chief Investment Officer

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.

FIGURE 1: RATE CUT EXPECTATIONS KEEP GETTING PUSHED OUT

Market-implied probabilities for the target fed funds rate upper limit by the end of 2024 (basis points, %)



Data sources: CME Group, Inc. CME FedWatch Tool as of 29 Feb 2024.

Investors still have the option to capitalize on current high yields across global bond markets.

Portfolio considerations

Heading into 2024, bond yields stood at their highest levels in more than a decade, prompting some market pundits and prognosticators to declare this "the year of fixed income!" It's too early to confirm that pronouncement, but there's evidence to support a strong showing across global bond markets. Within below-investment grade corporate credit, both fixed rate (high yield bonds) and floating rate (senior loans) assets have delivered attractive risk-adjusted returns compared to investment grade bonds, U.S. Treasuries and equities both recently and over the long term (Figure 2).

High yield currently benefits from strong technical and fundamental support. Given its fixed rate nature, previously issued high yield debt has been only marginally affected by rising rates, with interest coverage ratios now at a solid 4.5x. We expect high yield default rates to remain benign, especially since the average credit quality for the asset class has improved in recent years. Lastly, the sector's relatively high yields, along with lower duration risk relative to other fixed income categories, warrant investor attention.

We also believe floating rate loans look attractive in the current higher-for-longer rate environment, while many other fixed income sectors are challenged by it. Senior loans are well-positioned to complement the longer-duration profile of the broader fixed income market. Additionally, the yields offered by loans are among the highest available across public fixed income markets.

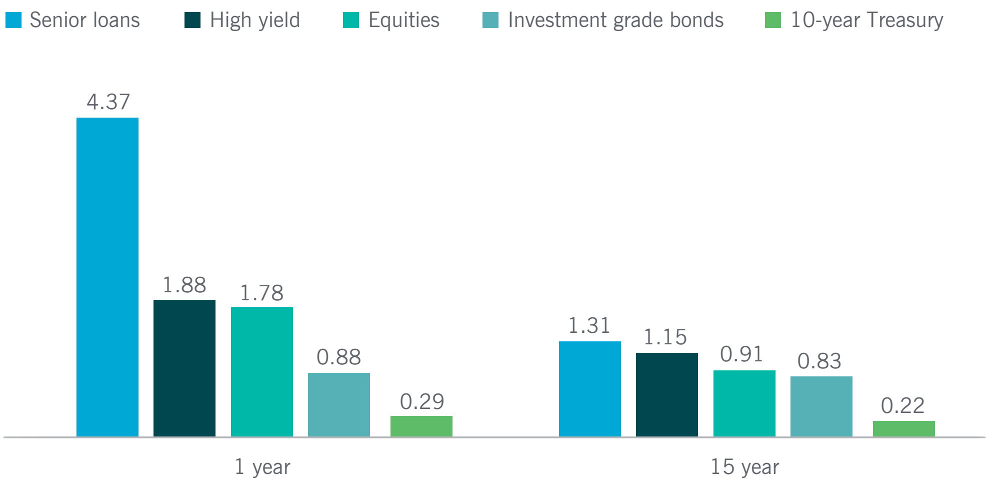
Overall, we favor higher quality sectors and enterprise revenue business models in both the high yield bond and senior loan categories. Within high yield, we're focused on sectors where we see recurring cash flows, sustained pricing power and high profitability, such as insurance brokers, telecom cables and wireline. For loans, we favor larger businesses with strong free cash flow profiles and limited near-term debt maturities. We are less constructive toward cyclical business models that may be vulnerable to potential cracks in consumer strength.

Looking ahead, we see the potential for both sectors to provide equity-like returns with lower volatility, a good match for what should be an uncertain economic environment. Active managers also have the ability to underweight or avoid lower-quality segments, which we think are more likely to struggle in a decelerating economy.

High yield bonds and senior loans are among our most favored sectors of the fixed income market.

FIGURE 2: BOTH SENIOR LOANS AND HIGH YIELD BONDS LOOK COMPELLING

Historical risk-adjusted returns (Sharpe ratios, %)



Data source: Bloomberg and JP Morgan Research, as of Dec 2023. **Performance data shown represents past performance and does not predict or guarantee future results.** Representative indices: **senior loans:** JP Morgan Leveraged Loan Index; **high yield:** JP Morgan High Yield Bond Index; **equities:** S&P 500 Index; **investment grade bonds:** JP Morgan JULIG Index. The **Sharpe ratio** is calculated by JP Morgan Research based on the annualized returns divided by the annualized standard deviation of each asset class.

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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