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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A developing story in emerging markets

Bottom line up top

U.S. Federal Reserve focuses on looser labor market data. With global central banks continuing to ponder their next steps in the face of moderating but still-elevated inflation, last week's data releases showed evidence of cooling in the U.S. labor market: ADP's private employment survey for February showed job growth slightly below consensus expectations (+140K versus +150K), while the "quits" rate reported in January's Job Openings and Labor Turnover Survey (JOLTS) fell to its lowest level since 2018, excluding pandemic-era data (Figure 1).

Meanwhile, despite an upside surprise in the Labor Department's nonfarm payrolls report for February (+275K net new jobs versus +200K expected), monthly tallies for January and December were revised downward by a combined 167K, and the unemployment rate ticked up to 3.9%. Perhaps most importantly in the context of inflation, wage growth came in lower than anticipated both for the month (+0.1% versus +0.3%) and year-over-year (+4.3% versus +4.5%). These data alone are unlikely to alter the trajectory of monetary policy, but in its February Beige Book, published last Wednesday, the Fed acknowledged that "overall, labor market tightness eased" last month, with "nearly all Districts highlighting some improvement in labor availability and employee retention."

The odds of rates moving down may be looking up. Over the past year, we have remained relatively hawkish compared to the markets regarding the timing and pace of Fed rate cuts, believing a pivot would be unlikely until mid-2024 — not during the first quarter, as many investors had hoped and expected. In the immediate wake of Friday's nonfarm payrolls release, however, market odds of a June rate cut increased substantially, aligning more

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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.

closely with our view. Because this timing would likely result in a weaker U.S. dollar, we think investors should explore portfolio allocation ideas outside the U.S., including opportunities in emerging fixed income and equity markets.

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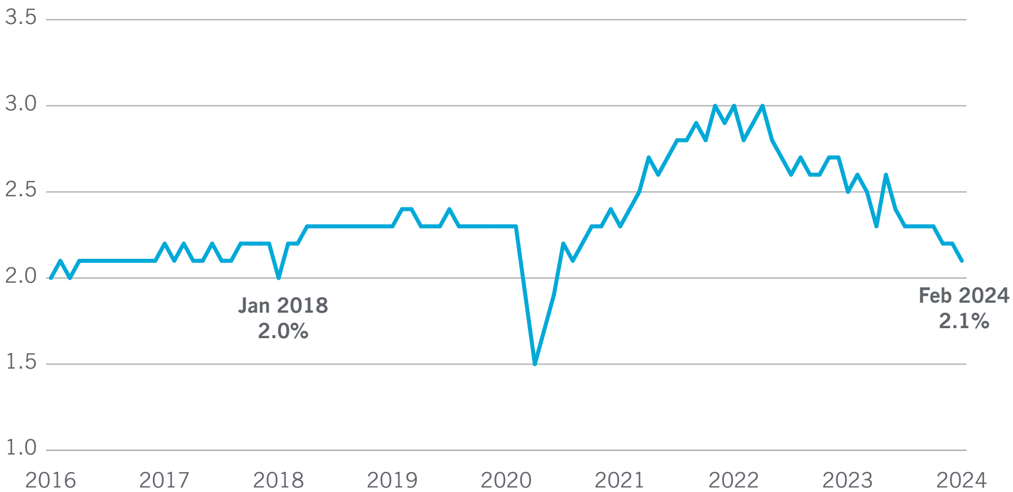
FIGURE 1: FEWER WORKERS QUITTING COULD LEAD TO LOWER WAGE GROWTH

Job Openings and Labor Turnover Survey, historical quit rates (%)



Data sources: U.S. Bureau of Labor Statistics, 06 Mar 2024.

Portfolio considerations

Forge strong bonds with emerging markets. The “year of fixed income” narrative put forth by pundits entering 2024 isn’t just a U.S. story; emerging markets (EM) debt also has a featured role in the script. EM offers compelling yields (around 8%), diversification and exposure to countries where effective inflation control has allowed some central banks to begin cutting policy rates. EM corporate bonds look particularly appealing, thanks to solid credit ratings, healthy spreads relative to sovereign debt and lower net leverage versus their developed-market peers. Within the corporate space, we prefer BBB and BB rated credits, whose spreads are more favorable than those of A rated issues.

Figure 2 shows the yield-versus-duration profiles of various EM, U.S., non-U.S. and global fixed income categories. Notably, EM corporates are predominantly investment grade (60%) with relatively low duration (around four years). This makes them a worthy complement to longer-duration sovereigns and to U.S. investment grade corporates, which yield 176 basis points (bps) less and have almost three years of additional duration exposure.

Take stock of EM equity opportunities. Among non-U.S. equities, we currently favor emerging over developed markets. EM stocks are attractively valued, offering over a 40% discount to U.S. shares on a forward price-to-earnings (P/E) basis. Additionally, allocating to EM equities provides exposure to countries with high real (adjusted for inflation) interest rates, such as Mexico. The Mexican economy has been a leading beneficiary of "nearshoring," as an increasing number of U.S. companies bring their operations and supply chains closer to home to take advantage of robust GDP growth, low unemployment and cooling inflation south of the border. This trend has made Mexico the largest U.S. manufacturing trade partner. In Brazil, the central bank has loosened monetary policy via rate cuts that began in August 2023, with inflation moderating even as the economy continues to outpace growth forecasts.

While China's stock market is too big to ignore — making up roughly 30% of the MSCI Emerging Markets Index — it has underperformed significantly amid less-than-promising Chinese economic data. That said, some green shoots may be forming. Last month, China's Beige Book showed that economic activity was improving, with stronger growth in corporate revenue and margins. Demand for consumer electronics during the Lunar New Year season was better than expected, although the bar was relatively low. Luxury apparel companies also benefited from healthier-than-anticipated demand. On balance, we remain cautious on Chinese equities, but we are closely monitoring the space.

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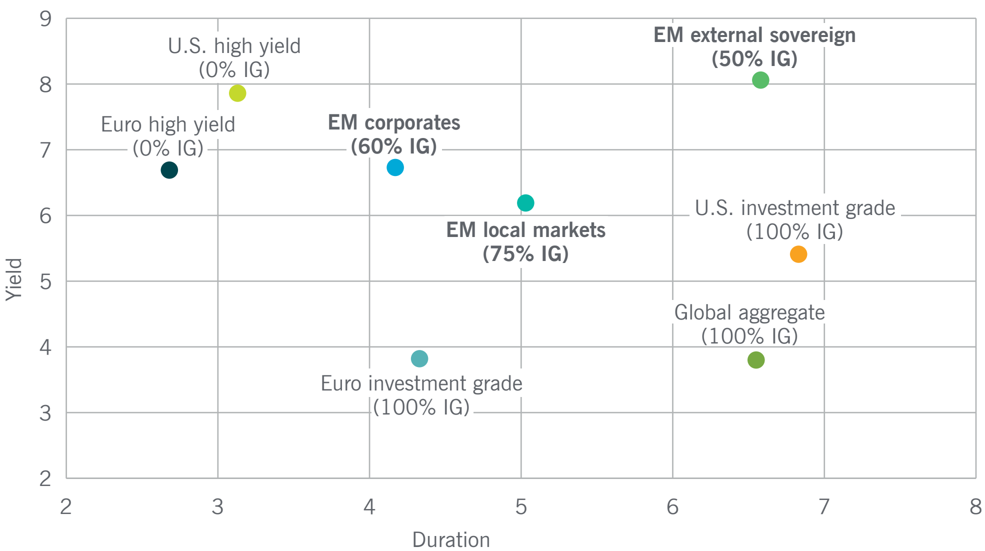
FIGURE 2: EMERGING MARKETS DEBT OFFERS INVESTMENT GRADE DURATION WITH HIGH YIELD INCOME

Duration (years) vs. yield of various fixed income indexes (%)



Data source: J.P. Morgan, Bloomberg L.P., Nuveen, 29 Feb 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: EM external sovereign:** JPM EMBI-GD; **EM corporate:** JPM CEMBI-D; **U.S. high yield:** Bloomberg U.S. Corporate HY; **U.S. investment grade:** Bloomberg U.S. Corporate IG; **Euro investment grade:** Bloomberg Euro-Aggregate Corporate IG; **Euro high yield:** Bloomberg Pan-European HY; **EM local markets**: JPM GBI-EM GD; **Global aggregate**: Bloomberg Global Agg Total Return 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

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Endnotes

Sources

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

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