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CIO Weekly Commentary
18 March 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Solving the 6% yield portfolio puzzle

Bottom line up top

Last month's inflation meets this week's U.S. Federal Reserve meeting. February data showed the Consumer Price Index (CPI) coming in slightly hotter than expected for the month, largely reflecting higher gasoline prices and sticky shelter costs. Core CPI (excluding food and energy) dipped to 3.8% year-over-year, slightly below January's print (Figure 1). Nevertheless, it's clear that consumer inflation isn't moderating quickly enough for Fed policymakers to begin easing at their next meeting on Wednesday. In fact, we think that the first rate cut is likely to be pushed out from an expected June timeframe to sometime in the second half of the year.

February wholesale inflation as measured by the Producer Price Index (PPI) was also released last week, with the core number rising a bit more than consensus for both the month (+0.3%) and year-over-year (+2.0%). This uptick in wholesale prices further confirms that the battle to bring down inflation is far from over.

Consumers tap the brakes. Retail sales, another key indicator that could impact the trajectory of inflation, fell short of forecasts in February. This could be a sign that spending momentum may be slowing, though it is not collapsing. Preliminary consumer sentiment data for March was essentially flat month-over-month, and modestly lower than expected. Sentiment remains well above 2023 levels and the historic lows hit during 2022's peak inflation.

Against the backdrop of persistent inflation and higher-for-longer interest rates, many investors are questioning how to adjust their investment strategy to produce attractive income levels that align with their risk appetite.

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.

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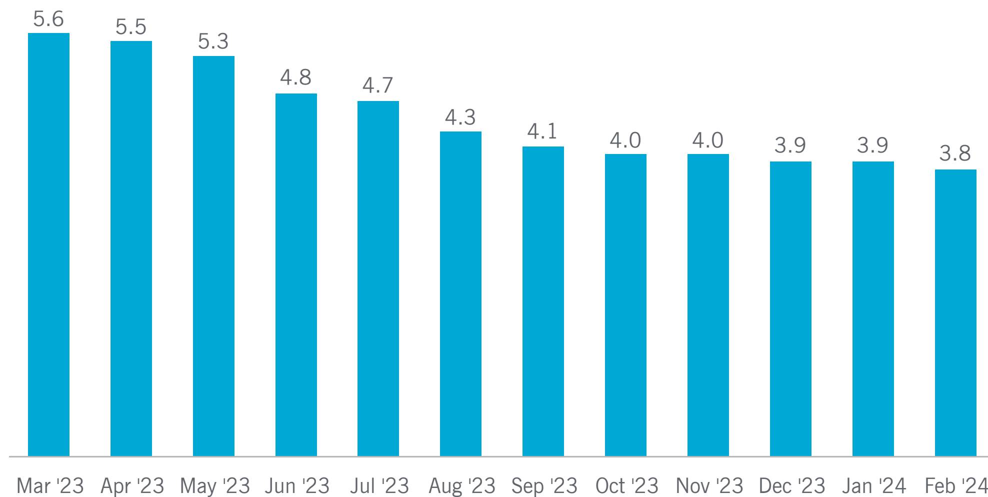
FIGURE 1: THE DECLINE IN CORE CPI HAS STALLED AT LEVELS WELL ABOVE THE FED'S 2% TARGET

U.S. core CPI, year-over-year (%)



Data sources: Bloomberg L.P., Nuveen, 29 Feb 2024. Index shown: U.S. CPI, all items less food and energy for all urban consumers.

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Portfolio considerations

Mystery fans and movie buffs of a certain age may recall *The Seven-Per-Cent Solution*, a mid-1970s best-selling Sherlock Holmes novel made into an Academy Award-nominated film. The story, an alternative version of key events chronicled in the official Holmes canon, put a number of long-accepted "truths" about the famous detective under the magnifying glass. Fortunately for investors, uncanny sleuthing skills aren't required to solve a present-day puzzle: how to build portfolios with a yield target that would have been unheard of only a couple of years ago.

Today's higher-yield environment has created opportunities to do just that. Below, we present a sample fixed income allocation that would have produced a 6% yield based on February month-end index data — call it *The Six-Per-Cent Solution* (Figure 2).

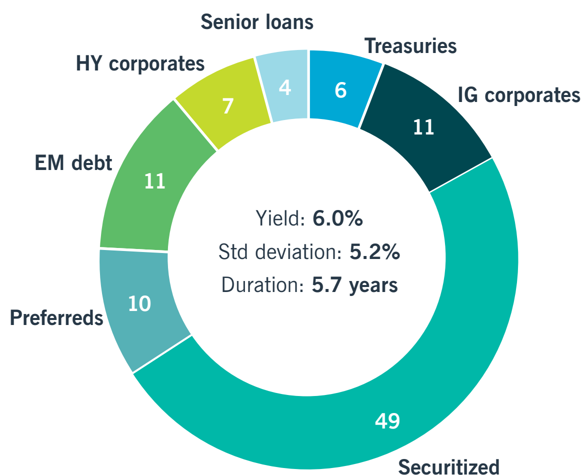
- In an environment where we believe inflation will continue to moderate, albeit more slowly than the consensus expects, a 6% yield would have provided a nearly 3% real (after inflation) income return — more than 100 basis points (bps) higher than the broad fixed income market (measured by the Bloomberg U.S. Aggregate Index).
- This sample allocation had a duration of 5.7 years, slightly shorter than the benchmark's 6.1 years. In our view, this close-to-neutral duration posture could be advantageous, with interest rates likely to decline gradually over 2024.
- Importantly, the reach for higher yield using these diversified sector exposures does not equate to significantly greater realized risk, with volatility (standard deviation) over the past 10 years at 5.15%, versus 4.77% for the benchmark.

- Securitized exposure includes agency and non-agency mortgage-backed securities (MBS) and asset-backed securities (ABS), both of which are supported by strong fundamentals. In addition, MBS spreads are wider than their historical average, while most fixed income sector spreads are relatively tight. Preferred securities, which also offer sound fundamentals, benefit from healthy investor demand given favorable tax treatment of the qualified dividend income that preferreds generate.
- Among non-U.S. categories, emerging markets (EM) corporate bonds are particularly appealing, thanks to solid credit ratings, healthy spreads relative to EM sovereign debt and lower net leverage versus their developed market peers. Notably, EM corporates are predominantly (60%) investment grade yet yield about 8%, with relatively short duration (around four years).
- Lastly, below-investment grade corporate credit has the potential to deliver equity-like returns with lower volatility. High yield bonds are bolstered by healthy interest coverage ratios (4.5x) and benign default rates, which we expect to continue. Floating rate loans may be an effective portfolio diversifier, with low correlations to fixed rate sectors and a shorter duration profile than the broader fixed income market. Moreover, the yields offered by loans are among the highest available in the public fixed income arena. The sample allocation's below-investment grade exposure favors higher-quality segments and issuers with enterprise revenue business models.

A well-constructed, multi-sector fixed income portfolio can take advantage of higher starting yields while offering diversification in an uncertain market.

FIGURE 2: A SAMPLE DIVERSIFIED MULTI-SECTOR FIXED INCOME ALLOCATION

Nontraditional income sample portfolio (%)



Data sources: Nuveen, Bloomberg L.P., 29 Feb 2024. **Performance data shown represents past performance and does not predict or guarantee future results. This exhibit reflects a sample fixed income allocation and is not intended to reflect any actual Nuveen product or service. Nuveen has developed these as representative example portfolios, and there is no guarantee that actual allocations will achieve the expected results.** Yield calculated as yield-to-worst. Standard deviation calculated on a 10-year historical basis using monthly returns from 28 Feb 2014 to 29 Feb 2024. **Representatives indexes: Treasuries:** Bloomberg U.S. Treasury Total Return Index; **IG corporates:** Bloomberg USD Liquid Investment Grade Corporate Total Return Index; **Securitized**: Bloomberg U.S. Securitized MBS/ABS/CMBS Total Return Index; **Preferreds:** ICE BofA US All Capital Securities Index; **EM debt:** J.P. Morgan EMBI Global Diversified Composite; **HY corporates:** Bloomberg U.S. Corporate High Yield Total Return Index; **Senior loans:** Credit Suisse Leveraged Loans Total Return Index. **Standard deviation** is calculated on a 10-year historical basis.

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. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. These risks may be magnified in emerging markets. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Investing in preferred securities entails certain risks, including preferred security risk, interest rate risk, income risk, credit risk, non-U.S. securities risk and concentration/nondiversification risk, among others. There are special risks associated with investing in preferred securities, including generally an absence of voting rights with respect to the issuing company unless certain events occur. Also in certain circumstances, an issuer of preferred securities may redeem the securities prior to a specified date. As with call provisions, a redemption by the issuer may negatively impact the return of the security held by an account. In addition, preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore will be subject to greater credit risk than those debt instruments. Credit risk is the risk that an issuer of a security will be unable to make dividend, interest and principal payments when due. Interest rate risk is the risk that interest rates will rise, causing fixed income securities prices to fall. Income risk is the risk that the income will decline because of falling market interest rates. This can result when an account invests the proceeds from new share sales, or from matured or called fixed income securities, at market interest rates that are below the account's current earnings rate. An investment in foreign securities entails risks such as adverse economic, political, currency, social or regulatory developments in a country including government seizure of assets, lack of liquidity and differing legal or accounting standards (non-U.S. securities risk). Preferred security investments are generally invested in a high percentage of the securities of companies principally engaged in the financial services sector, which makes these investments more susceptible to adverse economic or regulatory occurrences affecting that sector concentration/nondiversification risk). It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Nuveen, LLC provides investment solutions through its investment specialists.

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