Equities continue to climb the wall of worry

Investors continue to grapple with the Delta variant, the timing of Fed tapering and the uncertain path for additional fiscal stimulus. Despite this, the 10-year Treasury yield moved higher last week, indicating less concern about a Fed policy mistake. The S&P 500 has hit 53 record highs in 2021 and the market finished higher for a seventh consecutive month in August. The S&P 500 (+0.6%) and NASDAQ (+1.6%) rose last week, while the DJIA ended lower (-0.2%).

KEY POINTS

- **Economic data disappointed, but the market proved resilient and focused on positives such as corporate earnings and manufacturing.**
- **While the Delta variant contributed to the weak jobs report, we expect the increase in job growth to reaccelerate when the variant peaks.**
- **Despite China's PMI contracting, we continue to see opportunities in select local industries.**
- **The silver lining of soft economic data is that the Fed is likely to remain dovish, and may push back QE tapering to early 2022.**

Saira Malik, CFA
CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen as chair of the Equities Investment Council (EIC) and a member of Nuveen's Global Investment Committee (GIC). She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies, as well as portfolio management responsibilities for global equity strategies.

Market drivers & risks

- **August payrolls miss consensus expectations.** However, prior months saw upward revisions of 134,000, and payroll gains have averaged 750,000 over the past three months.
  - — August nonfarm payrolls increased 235,000, below consensus expectations for a 725,000 increase, marking the slowest pace of gains since last winter. Leisure and hospitality, as well as retail, experienced a meaningful slowdown in activity as the Delta variant was a bigger headwind than anticipated. The unemployment rate decreased to 5.2%, in line with expectations, while the participation rate was unchanged at 61.7%. With several Fed officials looking for stronger job gains, QE tapering may be delayed back to our original estimate of early 2022.
- **Global economic concerns may delay, but not derail, recovery.** China's growth is slowing while the ECB is contemplating reducing monetary policy accomodation.
  - — China's manufacturing PMI decreased into contraction territory at 49.2 in August, missing market estimates. This was the first contraction in factory activity since April 2020, and was adversely affected by measures to curb the Delta variant, supply bottlenecks and raw material costs. Fortunately, there has not been meaningful spillover from China's regulatory crackdown. While the economic situation in Europe benefits from high vaccination rates, data released last Tuesday suggested the euro area experienced its highest inflation rate in a decade in August at 3%, prompting hawkish ECB members to discuss tapering asset purchases despite Europe's still fragile economies.
- **"Strategic pause" on budget reconciliation bill.** Completing an additional fiscal stimulus package is becoming increasingly complicated.

> ***"Stocks continue to be supported by easy financial conditions and strong corporate earnings, but near-term economic data may lead to defensive and growth stocks outperforming."***

  - — Senator Joe Manchin (D-WV) wrote in *The Wall Street Journal* on Friday that Democrats need to assess the path of COVID-19 and determine if recent higher inflation readings are transitory before further advancing the $3.5 trillion budget reconciliation bill. The gap between moderates and progressives continues to widen, and without support from Senate moderates, progressives will likely not support the bipartisan infrastructure package that the House is scheduled to vote on this month. In the coming weeks, equity markets will price in higher taxes that come with the reconciliation package, and will work to increase the debt ceiling this fall.

Highlights from last week

- Seven of the 11 GICS sectors posted gains, with real estate (+4.0%) and health care (+1.7%) outperforming amid negative economic momentum. Defensive sectors (+1.9%) outperformed cyclicals (+0.2%), even as Treasuries showed modest curve steepening and 10-year yields increased 2 bps to 1.32%. Small caps (+0.7%) slightly outperformed large caps (+0.6%), while growth (+1.3%) outperformed value (-0.1%).
- The Hang Seng Index finished +2.0% as the spillover from China's regulatory crackdown seems contained. Japan's Nikkei Index finished +4.5% as the resignation of Prime Minister Suga is a catalyst for an improved pandemic response and stronger fiscal stimulus.

Risks to our outlook

The future of the budget reconciliation bill and additional stimulus has become more complicated. In addition, we anticipate delays with increasing the debt ceiling this fall.

Economic data from China has disappointed, as COVID-19 mitigation efforts slow the economic recovery. Further contraction may have implications for other economies and financial markets.

Equity markets remain susceptible to volatility and pullbacks, and may react negatively to weak economic data that misses consensus expectations.

Despite these challenges, economic underpinnings and fundamentals remain strong, and we still think that global equity markets will move past recent negative headlines.

Best ideas

Select stocks in cyclically oriented sectors should outperform, driven by discounted valuations and stronger relative earnings growth in developed non-U.S. markets, particularly in Europe. We remain broadly bullish on emerging markets, although are more guarded toward Chinese equities. As we work through mixed economic data in the U.S., we recommend a balanced portfolio approach with quality cyclical stocks that exhibit strong fundamentals, as well as less economically sensitive structural growth stocks.

In focus

U.S. consumers represent a wealth of equity opportunities

The strength of the U.S. consumer remains a source of compelling investment ideas. A confluence of factors such as increased savings, federal stimulus payments and rising equity and property markets have bolstered household wealth and personal balance sheets. This has created an environment in which consumers have been able to both pay down debt and spend on goods and services.

Consumer spending is currently growing at high single- to low double-digit percentage rates over 2019 levels. Although recent consumer confidence metrics have softened, this can be attributed to the spread of the Delta variant, adverse weather patterns (hurricanes) and transitory inflation due to supply chain disruptions. Fundamentally, consumers remain active and financially fit, reflected in footfall and credit card data.

We expect this strength to persist into the end of the year, as the labor market and broader economy should prove resilient even if there are some short-term hiccups in economic data. Against this backdrop, we favor select higher-quality consumer names, including pure discretionary plays in categories like athletic footwear, off-price retailers, cosmetics and casual dining.

At the same time, we are cognizant of the potential risks to our view, not limited to uncertainty about the Delta variant, extreme inflationary pressures that could stunt purchasing power and prolonged supply chain disruptions.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers, averaging three decades of investing experience. The EIC brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

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Sources

All market data from Bloomberg, Morningstar and FactSet.

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