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Weekly Equities Commentary

13 December 2021

Global equities rise as volatility subsides

Global equities rebounded last week thanks to strong data, policy and COVID-19-related headlines that either met or exceeded expectations. Among broad indexes, the S&P 500 had its best week since February, adding nearly 3.9%. The DJIA and tech-heavy NASDAQ gained 4.1% and 3.6%, respectively. Broad-based international equity market indexes also made significant weekly gains, as the MSCI EAFE and ACWI ex-USA indexes added 2.4% and 2.0%, while the MSCI EM appreciated 1.2%.

KEY POINTS

- **Volatility driven by Omicron may have run its course for now. So far, this variant appears to be milder, and vaccination has shown some effectiveness in initial studies.**
- **Headline CPI inflation reached a four-decade high in November, but did little to derail the rebound. The data was largely in-line with expectations and kept the Fed's tightening narrative intact.**
- **A debt ceiling resolution and a risk-on shift for Chinese equities also bolstered returns. While we are optimistic about a year-end equity rally, we remain wary of several downside risks.**

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

- **Headline CPI posted its highest year-over-year gain since 1982,** although this reading was in-line with expectations. Equities staged a relief rally on Friday despite the surge in inflation, as investors had feared a much worse outcome.
  - — Once again a limited number of components, including energy and food (meat/poultry), had an outsized impact on prices. However, a few bright spots emerged as the cost of used cars, lodging and airfare rose by less than expected, suggesting we may have seen (or will soon see) peak inflation. We believe this data will allow the Fed to proceed with an expedited taper, but won't necessarily accelerate the timeline for rate hikes — thereby providing scope for an upside surprise in equity returns in 2022.
- **Omicron** news drove a more than 50% spike in expected market volatility, as measured by the VIX Index, in the days following Thanksgiving, coinciding with the market's selloff.
  - — History has shown that significant (more than 40%) surges in the VIX during bull markets tend to result in positive returns in the subsequent six-month period. Less severe illness and favorable initial vaccine results suggest Omicron is unlikely to spur new economic restrictions, protecting the current bull market. Furthermore, the brunt of the variant's impact has been borne by energy prices. We expect this will reflect positively in future inflation readings, helping temper concerns about permanent price increases.
- **International equities also participated in last week's rally,** thanks to several tailwinds unrelated to Omicron.
  - — Regulatory risks have led to a challenged environment for Chinese stocks in 2021. But last week the CSI 300 Index posted its best three-day winning streak since May, thanks to falling factory inflation, supportive policy action from China's central bank and a pledge from Beijing to provide more macroeconomic stability. In the eurozone, the European Central Bank appears to be moving toward a temporary and limited increase to its asset purchasing program in an effort to avoid further market disruption. These narratives bode well for a year-end rally in global equities.

> ***"The next few months could remain challenging, with continued high volatility and possible near-term market selloffs."***

Highlights from last week

- All eleven sectors of the S&P 500 gained more than 2.5%. Favorable reports pertaining to the demand of one of the world's most popular smart phones and strong software earnings boosted the information technology sector to a 6% gain for the week. This sector currently accounts for roughly 30% of the index. Energy added 3.8%, thanks to rebounding oil prices, while consumer staples, materials, health care and industrials each added more than 3%.
- Several positive headlines were somewhat overlooked, including: (1) Initial jobless claims fell to yet another 52-year low of 184,000, beating the 194,000 tally from two weeks ago; and (2) Congress continued to make progress toward passing a debt limit extension, as the Senate passed a bipartisan resolution allowing future debt limits to be set by a simple majority vote (on a one-time basis).

Risks to our outlook

Inflation and its impact on central bank policy will continue to exert outsized influence on equity market volatility. The Fed's more hawkish tone came as a surprise, causing investors to grow leery of a potential misstep in the timing or magnitude of contractionary measures.

Though markets have seemingly concluded Omicron does not pose a significant threat, we still expect volatility to spike with each related headline. Although another COVID-19 wave had been anticipated, the fear of economic restrictions will likely remain an unwelcome overhang for global equity markets.

Congress continues to pose a risk despite creating a one-time resolution to the debt limit. The $1.7 trillion "soft" infrastructure spending package remains in jeopardy given the Democrats' razor-thin majority and significant objections from within their ranks.

Geopolitical tensions are on the rise again, this time on two fronts: Russia/Ukraine and Iran/Israel. While hopes remain high that disputes can be resolved at the negotiating table, any hint toward breakdowns in diplomacy will likely result in trouble for markets.

Best ideas

In the U.S., reflation and expectations for higher yields could bolster returns for small caps and financials, as well as companies with pricing power and reopening tailwinds. Supportive monetary policy and the prospect of stronger relative earnings growth could boost certain stocks in cyclically oriented sectors in developed non-U.S. markets, particularly in Europe and select emerging markets, ex-China. Select growth companies well positioned for reopening, such as front-office software leaders, also look attractive. Our long-term approach tilts toward cyclicals and value stocks that exhibit strong earnings growth and pricing power.

In focus

Dividends: stability amid volatility

Dividend stocks have performed well this year, as strong corporate earnings growth drove broader equity market participation. Within the S&P 500, dividend-paying companies have not only bested non-dividend payers, but they've also provided excess returns during spikes in volatility.

With uncertainty surrounding inflation and interest rates, we expect volatility to remain a persistent force. In our view, investors should favor dividends supported by healthy fundamentals, balance sheet strength, free cash flow and attractive relative valuations. Companies with these characteristics appear positioned to benefit from the reacceleration of economic growth, allowing them to return capital to shareholders.

We have already seen capital return programs being widely reinstated, a trend that we think will continue. Indeed, share repurchases and dividends have returned to near pre-pandemic levels, bolstered by earnings growth, margin expansion and greater confidence in the sustainability of the economic recovery. More than 300 S&P 500 constituents have declared a dividend increase so far this year, and according to FactSet, the index is expected to deliver 6% dividend growth in 2021.

While dividend increases are occurring broadly, cyclical areas like industrials and financials have declared the most. However, the strong earnings growth environment should result in continued dividend growth in sectors with lower dividend payout ratios such as information technology, health care and consumer discretionary.

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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