nuveen
A TIAA Company

CIO Weekly Commentary
1 August 2022

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Are "better than feared" earnings good enough?

Bottom line up top:

Thinner outlooks in the thick of earnings season. Last week's mash-up of earnings reports, another 75 bps rate hike and a negative GDP release sparking debate over whether the U.S. is already in a recession was enough to make any investor's head spin. "Spin" is also an apt description of how some headlines framed the week's Q2 earnings results: "better than feared." Fed Chair Jerome Powell's tone was likewise perceived as "less hawkish than feared," even though he didn't change his inflation-fighting tune, and rates are all but certain to climb higher before year-end. Meanwhile, revenue and earnings beats (Figure 1), however welcome, are backward-looking. Of greater import is that guidance for the rest of 2022 and beyond has turned much more cautious, potentially pressuring future earnings estimates.

A word or 10 to complement the numbers. All spin aside, earnings results from the second quarter have been objectively less favorable than in the recent past, with both the number of companies reporting positive earnings surprises and the magnitude of those beats below their five-year averages. What's behind the downshift? Part of the answer can be found by analyzing the transcripts of earnings calls to tally the topics most frequently cited by management teams in explaining their company financials (Figure 2). This "word cloud" shows that while expected terms like "revenue" and "guidance" dominate, red flags like "inflation" and "headwinds" are also turning up in force.

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: EARNINGS ARE MORE MUTED BUT STILL BEATING EXPECTATIONS. SO FAR.

Percentage of S&P 500 companies reporting positive 2Q revenue and earnings results

91-100% | 81-90% | 71-80% | 51-70% | 50% or below

Sector	Number of companies	Revenue	EPS
Overall	277	73.3%	79.1%
Materials	15	80.0%	80.0%
Industrials	45	73.3%	84.4%
Consumer staples	19	78.9%	89.5%
Energy	10	80.0%	90.0%
Technology	37	75.7%	75.7%
Consumer discretionary	31	67.7%	71.0%
Communications	12	66.7%	66.7%
Financials	50	60.0%	70.0%
Health care	31	74.2%	80.6%
Utilities	10	90.0%	90.0%
Real estate	17	94.1%	94.1%

Data source: Bloomberg, L.P., reported results as of 29 Jul 2022.

Guidance suggests corporate earnings could be in for a rough spell in the coming quarters.

Portfolio considerations

It's not just about equities. While typically viewed as an equity market indicator, corporate earnings are also relevant to other asset classes, and have broader economic implications as well. Bond investors, for example, have a keen focus on downside risk, so we sought an **earnings perspective from our senior fixed income portfolio managers** given risks in the macro picture.

Among the **key earnings trends they highlighted** are post-COVID normalization (the continuing shift from goods to services), softer consumer spending and the impact of inflation on top-line results and margins. Sector selection is crucial, as is a focus on higher-quality credits as the macroeconomic backdrop possibly deteriorates.

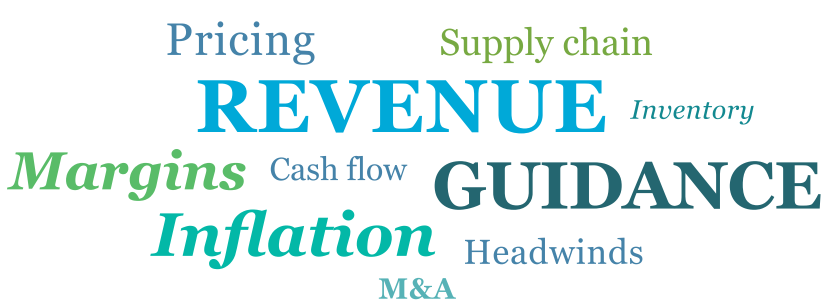
Richard Cheng, who manages investment grade strategies, **anticipates earnings will beat the lower end of forecasted ranges, but also foresees weaker guidance** as tightening by global central banks hampers growth. His focus: the magnitude of margin compression. Scott Caraher, Head of Senior Loans, is assessing the micro and macro views of corporate fundamentals as well as the market's reaction to **determine how much of the bad news is already priced in.** Our lead high yield portfolio manager, Kevin Lorenz, **expects idiosyncratic risk to drive performance** more than in the first half of the year, when rising rates and liquidity concerns outweighed other factors. Some of the weakest issuers, such as crypto companies, are most vulnerable to a slowing economy. In the second quarter, the high yield team materially shifted its focus from lower-quality (CCC) issues in favor of BBs.

Putting it all together: Amid heightened uncertainty around earnings for the remainder of 2022 and multiple macroeconomic headwinds, we suggest **treading cautiously within equities.** We view the recent ~10% bounce from the bear market low with some skepticism. At 17x forward earnings on the S&P 500 Index, investors aren't being adequately compensated for risk, in our view. For this reason we continue to favor stocks of higher-quality companies with strong balance sheets. **As for fixed income, we see opportunities in plus sectors,** where spreads across high yield, senior loans and preferred securities remain well above long-term averages.

> ***"We are in a credit picker's market again for the first time in a long time."***
>
> **Scott Caraher,**
> *Head of Senior Loans*

FIGURE 2: FORWARD GUIDANCE SUGGESTS TROUBLES AHEAD

Relative mentions of terms in 2Q earnings reports



Data source: Bloomberg, L.P. as of 29 Jul 2022. Size of each word represents the relative frequency of the specific terms used in 2Q S&P 500 earnings

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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature.

Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Past performance is no guarantee of future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

Nuveen provides investment advisory services through its investment specialists.

This information does not constitute investment research as defined under MiFID.