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Weekly Equities Commentary

16 February 2021

Markets continue to rise, but so do inflation risks

U.S. equities added to 2021 gains last week, with the S&P 500, Nasdaq and Russell 2000 again reaching intra-week record highs. This performance corresponded with a steady VIX reading in the relatively low mid-20s. Sector returns were mixed, led by energy and technology, which added 4.9% and 2.3%, respectively, while utilities lost 1.5%.

HIGHLIGHTS

- **Michigan Consumer Sentiment Index preliminary levels hit a six-month low at 76.2.**
- **Bank of America reported another week of record-setting equity inflows at $58.1 billion, led by technology stocks.**
- **Cannabis-related ETFs soared, as individual investors increasingly believe that U.S. lawmakers may further decriminalize marijuana.**

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.

Weekly overview

- *Market action was calmer last week, but the value/cyclical rotation fueled by coronavirus-relief persisted. Small cap and value outpaced their large and growth counterparts. On a sector basis, the more coronavirus-sensitive financials, materials and industrials sectors were among the biggest outperformers.*
- *The Biden administration announced steps to review certain tariffs and restrictions, including those imposed on the EU that impact aircraft, as well as certain Chinese social-media companies such as TikTok and WeChat.*
- *The Biden administration also announced it had secured 600 million vaccination doses, as Pfizer/BioNTech's two-dose vaccination has shown to be 66% effective with only one dose, comparable with Johnson and Johnson's vaccine.*

Market drivers & risks

- **Inflation remains subdued, but risks mount.** January's 0.3% CPI reading came in slightly weaker than expected, as core inflation grew only 1.4% over the past 12 months – well below the Fed's 2% target
  - While this does not suggest the economy is overheating, inflationary risks persist. Demand-driven supply strains are resulting from a rapidly reopening economy, prospects for "too much" stimulus and recovering commodity prices. Comparisons to March and April 2020 readings could lead to artificially high inflation data. These scenarios could easily result in fits of volatility, but we believe the Fed's commitment to looking past such near-term shocks will help avoid a recovery-induced taper tantrum.

> *"We expect 2021 to be a good year for stocks and an even better year for earnings and the economy."*

- **Lower-quality stocks are outperforming.** Since November's vaccine headlines, higher-quality companies (with lower debt levels and lower volatility) have underperformed their lower-quality counterparts. Surprisingly, this trend has expanded into earnings season. For the first time in more than a decade, higher-quality companies that have surpassed earnings estimates have lagged the market on the day of their earnings releases. Rather than rewarding these high quality companies for exceeding expectations, investors appear focused on lower-quality businesses they believe will experience an earnings recovery in the second half of the year. We think this trend could persist until a full economic "reopening" becomes a foregone conclusion.
- **Areas of opportunity.** We remain fairly optimistic through the first six weeks of 2021, based on increased vaccination rates leading to safer economic reopenings, combined with the likelihood of at least one more round of fiscal stimulus. We expect 2021 to be a good year for stocks and an even better year for earnings and the economy.
  - We expect small cap stocks to outperform, driven by economic progress and a new stimulus package, and we continue to prefer higher-quality stocks. Within technology, we prefer stocks benefiting from increased digital spending. We continue to favor the U.S. given its structural advantage with the digital economy and rapidly growing working-age population. Internationally, we continue to favor emerging markets, especially those countries indexed to technology and consumer industries.

Risks to our outlook

Coronavirus variants remain at the forefront of possible risks, given their propensity to spread more quickly and perhaps be more deadly. Additionally, AstraZeneca estimates it could take six to nine months before a new vaccine would be ready to combat these new strains.

Stimulus-driven volatility is likely to persist in the near-term, as Congress works toward passing the proposed $1.9 trillion package. Though chances for passage seem promising, President Biden has expressed a willingness toward concessions, such as backing off the $15-per-hour minimum wage.

Inflation risks may pose a bigger risk to our outlook than actual inflation, as any hint of tapering of quantitative easing may cause investors to overreact.

Best ideas

We continue to believe U.S. small caps offer value and remain favorable, poised to benefit from a re-opened economy and stimulus. Overall, our key investment theme centers on looking for quality across geographies, sectors and industries. Additionally, technology and consumer-related industries within emerging markets appear attractive.

In focus

Recovery and opportunity in energy

Given coronavirus-related restrictions, 2020 oil demand fell nearly 10% globally from 2019, according to International Energy Agency estimates. In response, OPEC and other major oil-exporting nations have reduced production by 10 million barrels a day since mid-2020 to help reduce inventories. As the global economy reopens through 2021, we expect a recovery approaching half of lost demand. However, jet fuel demand remains a lingering concern, as air travel will likely take longer to fully recover.

Oil prices have recovered to pre-pandemic levels, thanks to active supply management, and consumers will begin to see this reflected in higher gasoline costs. Oil's move higher will likely add to inflation concerns, as oil has lagged thus far relative to other commodities.

We believe energy-related equities have bottomed and should continue to improve on a relative basis. In addition to an improving oil market, management teams' focus on capital discipline and rewarding shareholders via dividends and share buybacks are also positives.

Increasing engagement in ESG issues is another positive, with a particular emphasis on emissions reduction, renewable energy and corporate governance. As the industry faces future demand risks and investors' growing desire for lower-carbon business models, companies that cannot make this transition will face an increasingly more stringent ESG filter aimed at avoiding laggards on these issues.

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 group 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

Manufacturing data from the Institute for Supply Management.

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