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A rates-driven correction creates opportunities in growth stocks

Equity markets saw gains as Treasury yields stabilized early last week. All major indexes climbed, with the tech-heavy Nasdaq ending its three-week losing streak and gaining 3.1%. Real estate (+5.9%) and consumer discretionary (+5.8%) led the way while communications services (+0.7%) and energy (+1.2%) were relative laggards.

HIGHLIGHTS

- **The 10-year Treasury yield closed at 1.64% on Friday after falling earlier in the week.**
- **Headline CPI for February met expectations (0.4%), while the core figure was softer (0.3%). Annualized data continues to fall short of the Fed's 2% target, reaching 1.3% last month.**
- **Weekly initial jobless claims of 712K beat expectations by nearly 20k, the lowest weekly reading since early November 2020.**



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

- *Stabilizing interest rates helped previously battered growth and tech-oriented names to recover following a three-week tumble. A solid round of Treasury auctions helped promote the risk-on trend.*
- *Though growth staged a modest recovery last week, Bloomberg noted value-oriented ETFs have attracted inflows for 10 consecutive weeks; combined with market appreciation, value assets have risen by \$100 billion since November.*
- *New York City and New Jersey have notably joined the ranks of states and regions relaxing economic restrictions. Prospects for additional economic openings are growing, with vaccinations solidly eclipsing the 2-million-per-day threshold and President Biden calling on all states to make vaccinations available to all American adults by May 1.*

Market drivers & risks

- **A localized correction.** The S&P 500 has so far avoided a correction in 2021 (although it dipped by 5% twice already) thanks to the outperformance of value and cyclicals. In contrast, growth and technology-oriented stocks suffered through a rapid rise in rates this year. The Nasdaq fell 11% from its peak on February 12 to early last week, with nearly one-third of the index falling by 12% or more.
 - See the accompanying “In Focus” section for a more detailed look at this topic.
- **The return of an ‘analog’ economy?** The American economy received one more “booster shot” last week in the form of the \$1.9T fiscal package. And with warmer weather around the



The next few months could remain challenging for investors, and continued high volatility and possible near-term market selloffs appear likely.

corner for large swaths of the population, we anticipate the American consumer will return with a vengeance (and in-person).

- Though the digital economy has made many aspects of life more efficient and convenient, vaccinated populations with record levels of savings will soon be able to visit gyms, theaters, brick-and-mortar retail, restaurants and sporting events. As a result, we remain confident in our modestly risk-on view that focuses on high-quality value and cyclical companies that have diligently adapted their ‘analog’ business models for a post-pandemic world.
- **Inflation risks remain a near-term obstacle.** The recent run-up in Treasury yields that triggered the growth-oriented correction is just one example of how inflation risks are generating market volatility. As economic activity picks up in the coming weeks, we are likely to encounter another risk in the form of positive demand shocks as global supply chains struggle to get back to full strength. This could be especially true for those industries tied to the epicenter of the pandemic.
 - Pandemic-fueled inefficiencies such as labor shortages have already caused logistical issues, including container vessel congestion at major U.S. ports. This type of supply dysfunction will likely lead to inflationary spikes in localized areas of the economy, including retailers taking advantage of near-term pricing power. Though we believe these issues will prove transitory as the global economy gets back on-line, investors are likely to experience volatility as they digest these dislocations.

Risks to our outlook

Investor fears of 'disorderly' yield growth and inflation risks remain a concern over the near-term, as markets have been quick to overreact (as observed on Thursday of last week). We will be paying particular attention to next week's Federal Reserve meeting and subsequent notes.

As mentioned, we will also be mindful of shocks to the global supply chain, as it is likely be another significant, but short-term, inflation risk.

Though vaccination rates have improved, complacency and the swift, broad-based elimination of regional economic restrictions could lead to spikes in cases, or possibly an additional wave, which could result in a significant near-term market correction.

In focus

Large cap growth: three tailwinds to consider

Faster secular growth: The large cap growth category is now defined as a collection of winners from the digital transformation across consumer, technology and healthcare sectors. In particular, we are seeing opportunities in dominant consumer-focused companies and select megacap technology areas that could experience faster growth over the next 5 years than the last 10 years. All else being equal, faster growth should equate to higher prices.

Improving profitability: The digital winners have driven an expansion in the free cash flow margin of large stocks from 4% (the 50-year average) to between 12% and 15% today. This provides another potential catalyst for growth as these companies can deploy free cash flow through dividend growth, share buybacks and acquisitions. As a point of reference, we expect some of the megacap tech companies could generate \$50 billion in free cash this year.

An attractive entry point: Growth stocks have sold off this year as Treasury yields have risen. This makes logical sense, as a higher discount rate results in a lower valuation for long duration growth stocks. But it is likely a one-time adjustment that has already happened. Many growth stocks have already fallen between 15% to 20%. We think this could represent an attractive entry point, as we expect Treasury yields could pause given that the Fed should remain on hold and non-U.S. bond yields are even further depressed.



Best ideas

We see select opportunities in some growth and technology-oriented companies made attractive by the recent correction. We continue to believe U.S. small caps remain favorable as they are 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.

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

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A word on risk

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