

22 March 2021

# Expect volatility as the focus returns to the Fed

*Equity markets fell last week driven by investors' reaction to the Federal Reserve meeting, which underscored expectations for a strong economic recovery, but did little to quell fears over rising inflation and bond yields. From a sector perspective, energy lost nearly 8% following big gains in oil prices and fears of a drop in European demand. Communication services, health care and consumer staples appreciated for the week, by 0.6% or less.*

## HIGHLIGHTS

- **The 10-year Treasury yield closed at 1.74% on Friday after falling earlier in the week.**
- **The Philadelphia Fed Manufacturing Index hit 51.8 in March's reading, doubling the expected 24.5.**
- **Initial jobless claims ticked up for the week ending March 13, reaching 770k, likely due to lingering impacts of severe weather throughout the U.S.**



**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.

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## Weekly overview

- *Interest rates retreated at the start of last week's trading, allowing for tech and momentum-driven stocks to continue their rebound. However, dovishness expressed by Fed Chair Powell following Wednesday's Federal Reserve meeting renewed the run-up in Treasury yields, putting downward pressure on stocks by the end of the week.*
- *Vaccination rates improved, as the Biden administration's goal of 100 million vaccine doses was achieved on Friday. Additionally, direct stimulus payments of \$242 billion reached 90 million Americans last week, just over half of the total amount to be distributed.*
- *The Fed declined to extend relief to its supplementary leverage ratio (SLR) requirement for banks, previously enacted to help battle the COVID crisis, causing bank stocks to sink on Friday. It did, however, leave the door open to adjustments to the SLR.*

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## Market drivers & risks

- **Fighting the Fed.** Chairman Powell's comments following Wednesday's meeting were largely in line with expectations: The central bank will remain accommodative as long as unemployment remains high and inflation remains below target. The Fed did not mention specific impending action to combat rising yields, but several members projected rate hikes in 2022 and 2023 in the "dot plot," acknowledging improving economic growth and rising inflation prospects.



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

- Markets initially reacted positively to this messaging, but reversed course on Thursday, as investors remain skeptical of the Fed's ability to adjust rates based on real data rather than expectations. We expect Fed policy and statements to prompt higher volatility as investors grapple with the growing pains of an expanding global economy. Economic and earnings growth should keep the reflation trade intact, favoring small caps and COVID-sensitive cyclicals, as rising rates may continue to drag on growth and momentum stocks. This should create pockets of opportunity and benefit active management.
- **Reopening realized.** As U.S. states vaccinate and make reopening adjustments at varying paces, we think it is important to consider differing expectations versus realities.
  - Importantly, vaccination rates are not yet indicators of economic growth. According to Earnest Research, total consumer spending remains highest in those states with lower vaccination rates (<25% of population). In contrast, travel booking growth has been the highest among the most vaccinated states (>25% of population), as are visits to gyms. Dining, another bellwether consumer industry, has also improved in states with higher vaccination rates. We expect overall economic growth should continue to improve broadly as the most populous states with the strongest restrictions (such as California) reopen.

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## Risks to our outlook

The Fed itself may remain one of the most important risks in the near term, simply due to market (over) reaction to its comments and (in)actions. Investor fears over “disorderly” rate growth and the Fed’s ability and willingness to react has created rapid bouts of volatility, such as what occurred on Thursday.

We are also mindful of possible shocks to the global supply chain, as those could cause notable, but short-term, inflation risks.

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



## 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.*

## *In focus*

# *A fertile environment for active management*

We believe active managers have better opportunities to add value when certain factors are present:

**When equal-weighted indexes outperform** cap-weighted, we expect more active management opportunities. The equal-weighted S&P 500 recently traded at a 52-week high vs. the cap-weighted index.

**Greater dispersion between winners and losers** should also create a more favorable environment. Many stocks outperforming the benchmark by a wide margin signals a higher degree of dispersion (and thus lower correlation) of returns. Despite the recent bout of market volatility, correlations for S&P 500 stocks remain near post-recession lows.

**Rising interest rates** make corporate earnings more important, since company fundamentals matter more and require a greater focus on those fundamentals. With the U.S. economy beginning to emerge from COVID-19, we expect interest rates to continue moving unevenly higher, which should benefit active management.

**Narrowing credit spreads** and an improving economy should also benefit active management, as accelerating earnings growth forces and rewards greater selectivity.

In our view, these factors should create an improved market environment for active managers and benefit those equipped to take a long-term investment view.

## 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.

## For more information or to subscribe, please visit [nuveen.com](https://nuveen.com).

### Sources

All market data from Bloomberg, Morningstar and FactSet  
Earnest Research, "The COVID Consumer, One Year Later," 18 March, 2021

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