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Weekly Equities Commentary

14 Jun 2021

Equities notch new highs despite hot inflation data

Global equity markets were mostly positive last week. In the U.S., the S&P 500 and tech-heavy Nasdaq added 0.4% and 1.9%, respectively, while the DJIA fell 0.8%. Elsewhere, the MSCI EAFE, EM, and ACWI ex-USA indexes notched nominal gains, between 0.1% and 0.3%, each. The S&P 500 reached a new record high of 4,247 at the close on Friday.

HIGHLIGHTS

- **May's headline and core CPI data were higher than expected at 5% and 3.8%, respectively.**
- **Initial jobless claims fell to 376,000 for the week ending June 5, representing the eighth consecutive recovery low.**
- **Job openings continue to surprise to the upside, as the latest data showed a more-than-expected 9.3 million openings.**
- **The 10-year U.S. Treasury yield continued to retreat last week, closing below 1.5% for the first time since early March.**

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

- *Last week's trading seemed to reflect an acceptance of higher inflation, as well as continued optimism for the ongoing recovery. The pullback on the 10-year Treasury yield allowed for technology and growth-oriented stocks to outperform.*
- *Results were mixed last week on a sector basis, as real estate and health care each gained 2%. Information technology (+1.4%), consumer discretionary (+1.6%) and communication services (+0.8%) were among the top performers, while industrials, materials and financials each lost over 1.7%. Growth beat out value, while small caps topped their large cap counterparts.*
- *The preliminary June reading of the University of Michigan Consumer Sentiment Index supports the ongoing recovery, as it rose to a better-than-expected 86.4. The report also showed more subdued inflation expectations by consumers compared to the May reading.*

"Reopening trends, vaccine rollouts, relative valuations and sector weightings suggest a bump for non-U.S. markets."

Market drivers & risks

- **CPI within a comfort zone.** Unlike their reaction to April's lofty CPI data, investors took May's higher-than-expected reading in stride. The S&P 500 closed at a new all-time high (4,239) on Thursday, when the inflation numbers were released, and again on Friday (4,247).
  - Though aggregate data remained elevated, last week's report revealed that price appreciation is still somewhat isolated and largely due to year-over-year comparisons. The largest increases were limited to used vehicles, energy and airfare. Given the lack of evidence of rampant, widespread inflation, we remain confident in the Fed's ability to stay on-message, even if discussions of tapering come a few quarters earlier than originally expected.
- **Rates moderate.** Falling Treasury yields reaffirmed that investors saw May's CPI data as further proof of transitory inflation.
  - Though cyclical and value trailed their technology and growth counterparts last week as bond yields moderated, their underperformance should be short-lived thanks to the strength of the ongoing economic recovery. We still recommend a barbelled approach of pairing high-quality, attractively priced growth companies with quality cyclical and value names tied to the recovery.
- **Reopening goes global.** Last week saw several pieces of positive news for the global recovery. The Biden administration pledged nearly 500 million vaccine doses to be distributed around the world, and the CDC relaxed travel guidelines for over 100 countries, allowing vaccinated Americans to resume non-essential travel to a number of destinations.
  - While measurable impacts of these two events will likely take time, any incremental improvements seen in vaccination rates outside the U.S., combined with increased spending by well-capitalized Americans abroad, would certainly be a welcome sign for local markets and investors.

Risks to our outlook

Though inflation concerns appear to have moderated, we expect volatility to spike around further data indicating accelerating wage growth and/or prices. Should price increases begin to spread beyond their current narrow scope, or if employers continue to hike pay to attract or retain workers, the Fed may feel the need to more openly discussing tapering.

Related, we think labor supply constraints may exert a drag on the economy's return to "normal." With businesses finding it increasingly difficult to fill positions, we are starting to see signs of flattening mobility, which could hamper economic and earnings growth.

We are mindful that the COVID-19 pandemic remains a serious challenge, despite largely successful vaccination efforts in the U.S. and other developed countries. Continuing to reopen the economy at the current or accelerated pace could present the risk of another spike in case counts, potentially leading to localized or regional shutdowns and an air pocket in the recovery. This would almost certainly weigh on investor sentiment and spark further volatility.

Best ideas

Improvements in vaccinations and economic reopenings make U.S. small caps particularly attractive. We are also seeing near-term opportunities in Europe, which looks relatively inexpensive and should benefit from continued easy monetary policy. We favor industrials that will likely benefit from publicly funded infrastructure investments and higher capital expenditures. We also remain bullish on emerging markets over the long term and expect necessary efforts to stem the spread of the virus will eventually take hold.

In focus

Better times ahead for non-U.S. stocks

While the global economic recovery continues, its rate has varied. This diverges from our optimistic expectations earlier in the year that called for a synchronized global economic expansion that we believed would lead to non-U.S. equities outperforming their U.S. counterparts. Although staggered recovery rates have led to moderate underperformance for developed non-U.S. equities this year, we believe better conditions may be on the way. The combination of extensive fiscal and monetary policy stimulus should soon give way to improved vaccination rates as the core driver of economic activity, similar to what we have observed in the U.S.

As has been the case in the U.S., non-U.S. equity returns should be helped by significant earnings growth, which aren't expected to peak until the second half of 2021. In contrast, we expect U.S. earnings growth to decelerate through the back half of the year. This bodes well for non-U.S. stocks, especially in Europe, which is more cyclically oriented. More broadly, the MSCI EAFE Index has higher weightings in industrials, financials and materials, and is significantly underweight information technology, when compared to the S&P 500.

A variety of other market conditions support the thesis for stronger non-U.S. returns, including elevated interest rates in the U.S., relatively attractive valuations for developed international stocks and the weak state of the U.S. dollar, which could bolster returns in non-U.S. developed and emerging markets.

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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