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Weekly Equities Commentary

20 Sep 2021

September seasonality offers buying opportunities

Equities finished mostly lower last week as investors continue to work through economic normalization challenges from the Delta variant, the expectation of Fed tapering, input price pressures and economic data concerns. The S&P 500 (-0.5%), DJIA (-0.1%) and Nasdaq (-0.5%) all fell. Though the economy has slowed, it has not been derailed. Our view is that consumers will drive economic and earnings growth into 2022, and market pullbacks might create buying opportunities.

KEY POINTS

- **Strong August retail sales data and surprises from the manufacturing indexes increase the likelihood that the Fed will begin to taper before year end.**
- **A combination of August's lower core CPI reading and a lower market suggests that transitory inflation is now priced in.**
- **House Democrats outlined funding for their reconciliation bill, which we believe may overcome objections to the fiscal stimulus package.**
- **News about Chinese regulatory changes continued, but the odds of a policy pivot are increasing.**

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.

Market drivers & risks

- **The CPI reading and retail sales data may alleviate inflation and growth concerns.** But economic normalization headwinds due to the Delta variant remain a risk to economic growth.
  - Core CPI remained soft in August, increasing 0.1% month-over-month. While this took some pressure off transitory inflation, some of this moderation is a function of the continued spread of the Delta variant. But consumer sentiment may be more resilient, as shown by increasing retail sales across several key categories last month. Headline retail sales were up 0.7% month-over-month. Overall, the recent slowdown in economic data appears to be temporary. Even as we eagerly await clarity on the beginning of Fed tapering, we recognize that monetary policy will remain growth oriented well into 2022.
- **U.S. tax and spending plans are in place,** but the ultimate outcome remains unclear.
  - House Democrats proposed legislation with tax increases that would boost revenues by $2.9 trillion to help finance the $3.5 trillion spending package. At the center of the tax changes are increases in the corporate tax rate (to 26.5% from 21.0%) and the minimum tax on U.S. companies' foreign income (to 16.5% from 10.5%). The top capital gains tax rate would also rise to 25.0% from 23.8%. While these tax hikes are not as severe as originally proposed, the market is starting to price in the effect on earnings. We continue to monitor the intra-party debate between moderates and progressives.
- **China's regulatory actions lead to further cautious headlines.** Macau casino stocks moved lower on concerns about a gambling crackdown.
  - Hong Kong-listed casino companies with operations in Macau plunged last week on fears of stricter regulation from the Chinese government. With Macau's lucrative casino licenses up for rebidding next year, the prospect of more government intrusion hurt a market already reeling from Beijing's regulatory crackdown on sectors ranging from technology to education and property. Discussions about the future of Macau's casino licenses have some investors fearing an advantage for Chinese-domiciled casino operators, compared to U.S.-based counterparts. In addition, worries about the systemic risks posed by Chinese property developer Evergrande's debt troubles are increasing. Between ongoing regulatory changes, challenges in the property sector and signs that the economy is losing momentum, a policy pivot may add support.

"Cautious sentiment may continue, but an anticipated resumption in economic and earnings growth merits a constructive narrative for equity markets."

Highlights from last week

- Nine of the 11 GICS sectors posted losses, with materials (-3.2%), utilities (-3.1%) and industrials (-1.5%) leading the market lower. Energy (+3.3%) moved higher with continued strength in oil prices, and financials (-0.1%), though negative, were a relative outperformer. Cyclical sectors (-0.5%) edged defensives (-0.6%) even as Treasuries were mostly weaker. Small caps (+0.5%) outperformed large caps (-0.5%), while value (-0.3%) fared modestly better than growth (-0.6%).
- FactSet's bottom-up S&P 500 EPS estimate for Q3 earnings has increased 3.7% intra-quarter, versus a 5-year average decrease of 2.9%.

Risks to our outlook

Between healthy retail sales and solid manufacturing surveys, our view appears to be correct that a strong consumer and manufacturing data will be the key drivers of growth. However, this likely increases the chances of a tapering announcement sooner rather than later, and probably starts the clock on actual tapering before year end.

Markets are beginning to assess proposals that would increase the corporate tax rate and the minimum tax on U.S. companies' income earned overseas.

The near-term path of least resistance for stock prices could be lower, as equity markets may react negatively to a slowing of earnings revisions momentum, the forecast for Fed tapering and stumbling blocks to reconciliation and stimulus.

Despite these risks, global economic and equity market fundamentals remain strong, and we still think markets can successfully navigate the current macro headwinds.

Best ideas

Supportive monetary policy and stronger relative earnings growth in developed non-U.S. markets, particularly Europe, will be the catalyst for select stocks in cyclically oriented sectors to outperform. We remain broadly bullish on emerging markets, but continue to monitor the regulatory environment in China. Near term in the U.S., we are adding to defensive sectors and structural growth stocks. At the same time, we favor a long-term approach that balances these exposures with cyclicals and value stocks exhibiting strong earnings growth and pricing power.

In focus

Semiconductor shortage shows no sign of ending

Of all the supply chain disruptions plaguing the economy, none has been as exasperating as the shortage of semiconductor chips — essential to the manufacture of virtually every modern device, appliance or vehicle with electronic components.

COVID-19-related factory closings and shipping logjams, along with surging demand for consumer electronics, are both contributing to the far-reaching shortage.

The auto industry has been particularly hard hit. One trade association estimates that U.S. carmakers will produce 1.28 million fewer vehicles this year, a number we think may be too low. Meanwhile, the lack of new production has fueled a spike in used car prices, contributing to rising inflationary pressures in recent months.

Relief is also not yet in sight. Our equity research analysts expect sequential improvements in chip availability in mid-2022, which should ease supply bottlenecks, and a possible return to normal by the end of next year. In the meantime, semiconductor stocks have held up reasonably well. Last week they traded to a five-month high relative to the S&P 500 (on an equal-weighted basis).

Looking ahead, we remain structurally positive on semiconductor names and see particular opportunities in companies tied to long-term megatrends in artificial intelligence, 5G, data centers, video games and autos, including electric vehicles.

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 EIC 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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