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# Earnings drive equities to record levels

*Last week global equity markets continued a three-week winning streak on the strength of earnings. In the U.S., the S&P 500 Index closed 1.7% higher, setting a new record on Thursday, with the DJIA and NASDAQ each adding over 1% as well. Outside the U.S., the MSCI EAFE, EM, and ACWI ex USA appreciated 0.6%, 0.8% and 0.7%, respectively.*

## KEY POINTS

- **We are seeing margin pressure during this earnings season due to the headwinds of rising costs and supply chain disruptions.**
- **We remain committed to an approach of selecting quality growth and value names as economic expansion continues to slow.**
- **Falling jobless claims and other positive data continue to support our view that the Delta variant delayed economic growth, but didn't end it.**
- **We remain vigilant on inflation, but eventual relief for supply chains should help normalize prices.**



**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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## Market drivers & risks

- **Skepticism about the Federal Reserve’s plan for interest rates remains high**, as markets appear to be pricing in rate hikes sooner than the timeframe the Fed has communicated.
  - Although the Fed set 2023 for rate “lift-off,” markets have been clear about their lack of faith in the central bank’s ability to preserve long-term growth. Currently, markets are pricing in two rate hikes for 2022 and three more in 2023. We believe the Fed can remain more dovish than markets think, as long as wage inflation pressures don’t worsen. But any policy misstep could create significant volatility.
- **Negotiations on an infrastructure spending package appear to be reaching a critical point**, as some in D.C. believe a vote on a bipartisan deal may come as early as this week.
  - This accelerated timeframe appears optimistic given the number of potential hurdles that remain in securing enough votes. But one critical piece of information was confirmed: President Biden admitted publicly that there are likely not enough votes to pass a corporate tax increase. This development could remove what had been a notable overhang for equity markets, with some estimates calling for a 5% hit to the S&P 500’s 2022 earnings should the tax rate climb from 21% to 25%.
- **Earnings growth rates remain strong relative to historical averages**, but they have slowed significantly versus the previous two quarters.
  - Blended earnings growth for the S&P 500 has reached 33%, which would be the third-highest growth rate since 2010 if it holds — bested only by 2Q21 (91%) and 1Q21 (52%). This 33% rate is



*The next few months could remain challenging, and continued high volatility and possible near-term market selloffs are likely.”*

also higher than consensus estimates of 27% as of 30 September. Despite decelerating earnings growth, better-than-expected results overall and recently compressed valuations helped drive the S&P 500 to a new all-time high.

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## Highlights from last week

- Ten of the eleven GICS sectors posted gains for the second consecutive week on strong earnings, the growing probability of an infrastructure spending bill and continued improvements in COVID-19 trends. The real estate sector added 3.2%. Health care, financials and utilities each added between 2.0% and 3.0%. Communications services (-0.6%) showed the lone negative return, again, due to the ripple effect of disappointing earnings from a well-known media & services company. Every other sector gained between 0.9% and 2.0%.
- Questions as to how sustainable the “buy the dip” mentality may be were answered when weekly global equity fund inflows hit a five-week high for the week ending 20 October. That influx of dollars came on the heels of a more than 5% drop in the S&P 500 that ended in early October. Both technology and financial stocks enjoyed significant inflows, with secular growth supporting the former and rising rates the latter.

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## Risks to our outlook

The Fed will be under intense scrutiny as it tiptoes toward tapering. With markets so accustomed to quantitative easing and low rates, volatility is likely to rise as investors grow leery of a misstep in timing or magnitude.

The agreement to delay the U.S. debt ceiling deadline may have calmed markets for now, but volatility may continue to rear its head as the December 3 deadline approaches.

Earnings season could prove to be more of a headwind for equities, as investors begin to digest the true fallout from the Delta variant surge, tax and regulatory risks from legislative plans, supply chain issues and corporate warnings.

Though it appears as though U.S. corporate tax rate hikes may ultimately be avoided, markets must still assess the expected impacts of potential increases in other U.S. tax rates, including a minimum tax on U.S. companies' foreign income.

COVID-19 variants, such as the Delta subvariant discovered in the U.K., are likely to continue to inject volatility into global equity markets.

## *In focus*

# *A second life for medical tech*

Medical technology continues to be one of the most sensitive industries to global COVID-19 case counts and hospitalizations, given the pandemic's impact on the timing of elective medical procedures.

Outside of a few select areas (cardiology, neurovascular), most procedures can be deferred for months or even years. Such delays became the norm in 2020 as hospitals paused elective procedures. The result: Medical tech's growth was stymied, causing broad revenue declines across the industry. Even as vaccine rollouts accelerated, the virus surged in the winter and summer of 2021, leading to more delays in elective procedures.

Despite the challenges, we are growing more bullish on these companies, especially with the peak in Delta variant cases likely behind us. Longer term, we believe evolving medical technologies will lead to fewer complications and shorter hospital stays, at times providing alternatives to drug treatments that may carry adverse side effects.

We expect the pandemic's impact on health care systems to diminish as vaccinations continue to climb and better patient-management protocols help alleviate the backlog of procedures. COVID-19 has also served as a catalyst to shift elective procedures away from acute care hospitals and into lower cost outpatient facilities.

Lastly, COVID-19 headwinds have resulted in relatively attractive valuations for medtech companies compared to their historical premiums versus the S&P 500.



## *Best ideas*

*In the U.S., reflation and expectations for higher yields could bolster returns for small caps, as well as companies with pricing power and reopening tailwinds. Supportive monetary policy and the prospect of stronger relative earnings growth could boost select stocks in cyclically oriented sectors in developed non-U.S. markets, particularly in Europe and select emerging markets, ex-China. Select growth companies well-positioned for reopening, such as front-office software leaders, also look attractive. Our long-term approach tilts toward cyclicals and value stocks exhibiting strong earnings growth and pricing power.*

## 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.

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

### Sources

All market data from Bloomberg, Morningstar and FactSet.

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