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October's equity gains erase September's losses

U.S. equities rose for the third consecutive week, while their non-U.S. counterparts were down slightly. The S&P 500, DJIA and tech-heavy Nasdaq added 1.4%, 0.4% and 2.7%, respectively, while the MSCI EAFE (-0.1%) and ACWI ex USA (-0.8%) fell modestly. The MSCI Emerging Markets (EM) Index, weighed down by heavy losses in China, fared worse (-2.2%). These indexes all appreciated in October, however, each gaining between 1.0% and 7.3%, with the larger returns in the U.S.

KEY POINTS

- **Equity valuations have reflatd thanks to strong October performance. With more than half of S&P 500 companies reporting 3Q earnings, finding the next catalyst for markets could be a near-term challenge.**
- **Amid growing expectations of multiple Fed interest rate increases in 2022, equity markets will likely only move higher if investors remain convinced that economic growth won't be stymied by a policy error.**
- **Though 3Q GDP growth slowed, service industries experienced a significant increase in activity — a sign that Delta variant concerns are abating.**



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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

- **U.S. GDP grew at its slowest pace of the pandemic recovery**, expanding by an annualized 2% in the third quarter, short of expectations. The good news is this miss came as a relief to markets, which had feared a growth rate of zero.
 - This confirms what we already knew: Peak growth is behind us. But we anticipate a re-acceleration thanks to several factors. First, consumer spending rotated from goods to services during the quarter, a trend that should help alleviate inflationary pressures. Second, COVID-19 infections appear to have peaked just as boosters are becoming available to a growing percentage of the population — hopefully preventing another surge. These factors, combined with a possible infrastructure package, should allow growth to continue into 2022.
- **The style debate drags on**, as markets grapple with rate volatility, inflation and caution about central bank policy.
 - Growth and value equities continue to trade jabs, with leadership shifting monthly, weekly and even daily. Although last week's retreat in rates allowed growth to outperform, poor 3Q earnings reports for several tech giants weighed heavily, giving some investors pause as to how much more upside growth may have following a remarkable 2020 and 2021. While secular trends may favor growth-oriented industries, the next move in interest rates will almost certainly be upward, which should enable cyclical sectors to outperform their growth/defensive counterparts.
- **Earnings drove another round of gains**, and will likely be a primary market driver given how far valuations expanded in October. However, we are mindful of decelerating earnings growth which could limit market appreciation in the near term.
 - 82% of S&P 500 constituents reporting 3Q results have beaten consensus expectations, with a blended earnings growth rate of nearly 37%



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

year-over-year, up from last week's 33%. This rate now exceeds the 35% growth we expected at the beginning of earnings season. While the rate and magnitude of beats has allowed stock prices to grind higher following a difficult September, identifying a catalyst for the next leg up has become more challenging. As a result, we foresee a return to a stock-picker's market and choose to remain focused on companies with cyclical/ secular tailwinds and pricing power to overcome persistent inflation.

Highlights from last week

- Trading favored technology and growth stocks, as the 10-year U.S. Treasury yield retreated below 1.6%. Both the Russell 1000 and 2000 Growth Indexes outpaced their value counterparts. Consumer discretionary added 4% on strong auto earnings, while communication services and information technology each added 2.0%. Conversely, financials (-0.8%), energy (-0.6%) and utilities (-0.5%) fell the most for the week.
- Economic data released remained generally supportive, even though certain metrics have peaked or missed expectations. On a month-to-month basis, core PCE (the Fed's preferred inflation barometer) edged down in September to 0.2%, the lowest observed rate since February and a sign of the transitory nature of recently elevated inflation levels. Year-over-year, core PCE stayed at 3.6% for the fourth consecutive month. Meanwhile, Chicago's PMI index rose to 68.4, its first increase in three months, outpacing expectations

Risks to our outlook

The Fed will be under intense scrutiny as it tiptoes toward contractionary policy. With markets so accustomed to quantitative easing and low rates, volatility is likely to rise as investors grow leery of a possible 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 injecting volatility into global equity markets.

In focus

REITs build on their recovery

Real estate investment trusts (REITs) remain one of the best-performing equity sectors in 2021. The FTSE Nareit All Equity REITs Index has gained 30.2%, outpacing the S&P 500 (+24.0%). These strong returns have been driven by a confluence of factors across most property sectors as the negative impacts from COVID-19 fade and a broad economic recovery endures.

Though REITs are trading at a roughly 12% premium to net asset value (NAV), this number may be misleading. An argument can be made that NAVs are understated as increased replacement costs (due to inflation) are leading to higher property values (which would result in lower premiums). Additionally, individual sector valuations are still mixed. Property types that have benefited from a tailwind of an expanding digital economy (e.g., industrials and data centers) are trading at higher multiples than more cyclical sectors, such as retail.

Although some COVID-19-related impairments may be more permanent, particularly in the office sector, our outlook is constructive. Internal growth rates continue to accelerate for many property types, including industrial and self-storage, while pandemic-sensitive sectors such as apartments have seen improvements in fundamentals. More broadly, our confidence in commercial real estate over the long term is underpinned by billions of dollars of private equity capital waiting to be deployed, an accommodative borrowing environment, increased replacement costs, the historical hedge to inflation that REITs represent and strengthening fundamentals.



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://www.nuveen.com).

Sources

All market data from Bloomberg, Morningstar and FactSet.

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A word on risk

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