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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

"Stagflation" may not mean what you think

Bottom line up top:

This is not your father's stagflation (or anyone else's, for that matter). Strictly speaking, stagflation occurs when deteriorating growth and rising unemployment are accompanied by hotter inflation — an unusual combination that hobbled the U.S. economy for a number of years in the 1970s. Despite headlines proclaiming or predicting the return of this unwelcome phenomenon, we don't think '70s-style stagflation is destined for a comeback any time soon.

Here's what's different this time. It's true that growth is moderating from last year's robust pace, amid high inflation and an oil price shock that for some may bring to mind the 1973 oil embargo and 1979 energy crisis. But the economy wasn't just slowing from 1973 to 1975, it was in recession. Unemployment climbed as high as 9% in 1975 (versus 3.8% today). Moreover, in those days the U.S. was importing more than a third of its oil from OPEC and other producers, whereas today that figure is significantly lower, about 20%. Lastly, stagflation in the '70s was precipitated in part by dubious policy decisions unique to the era, including wage and price freezes enacted in 1971.

Investors resigned to the prospect of stagflation have choices. Over the past few weeks we've considered the portfolio implications of higher-for-longer energy prices and increased market volatility. Many of the investments we identified as potential outperformers in those environments could also prove resilient if, contrary to our outlook, stagflation were to materialize. Below we take a closer look at these ideas using historical analysis of asset class results from the 1970s.

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Chief Investment Officer

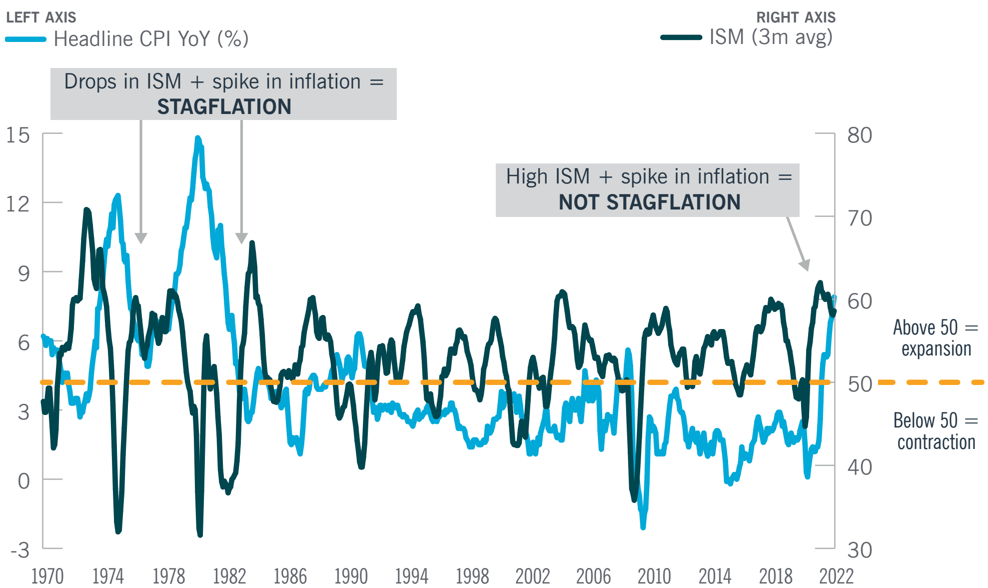
On behalf of Nuveen's Global Investment Committee

As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

Portfolio implications for a stagflation scenario

U.S. economic data supports still healthy (albeit modestly slower) growth. As we noted in our outlook heading into 2022, some deceleration was to be expected this year. One example shows up in the ISM manufacturing index. This cyclical indicator has come off its peak since May 2021 amid sharply higher inflation, but it remains firmly in expansion territory (Figure 1). At its current level, the index is consistent with U.S. GDP growth of about 4.1% — in stark contrast to its behavior during the stagflationary '70s.

FIGURE 1: INFLATION IS HIGH, BUT ISM ACTIVITY SHOWS THE LACK OF "STAG"



Data source: Bloomberg L.P., Bureau of Labor Statistics, Institute of Supply Management, 28 Feb 2022.

What actually happened in the 1970s. While stagflation is far from our base case, some investors are focused on the risk of a slow-growth, high-inflation environment resembling the bad old days. Which asset classes proved resilient then? Commodities — particularly gold and oil — outperformed, based on annualized real returns, while stocks were the obvious underperformers (Figure 2). But to better understand investment performance during the stagflation era, it's helpful to divide it into four "Acts."

- "Act 1" (1973 – 1975) saw most of the commodity gains and equity losses, along with a real estate slowdown and a crash in the then-nascent U.S. REITs market.

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- "Act 2" followed from 1975 – 1976 with bull markets in equities and real estate, along with a severe drawdown in commodities and a cooling of inflationary pressures that is often forgotten.
- In "Act 3," higher inflation returned with a vengeance, and new Fed chair Paul Volcker employed aggressive monetary tightening that ultimately led to the second recession of the decade.
- "Act 4" culminated with fading inflation and another painful stretch for commodities.

Lessons for today? Recent asset class performance looks similar to that of the mid-to-late 1970s, when U.S. REITs and equities fared well after the initial commodity shock that started the decade. For today's stagflation-wary investors, this suggests a portfolio with broadly diversified exposure to commodities, real assets and equities. At the same time, these investors may take comfort in knowing that today's Fed is better equipped and more committed than its pre-Volcker counterparts to take an active role in combating higher inflation.

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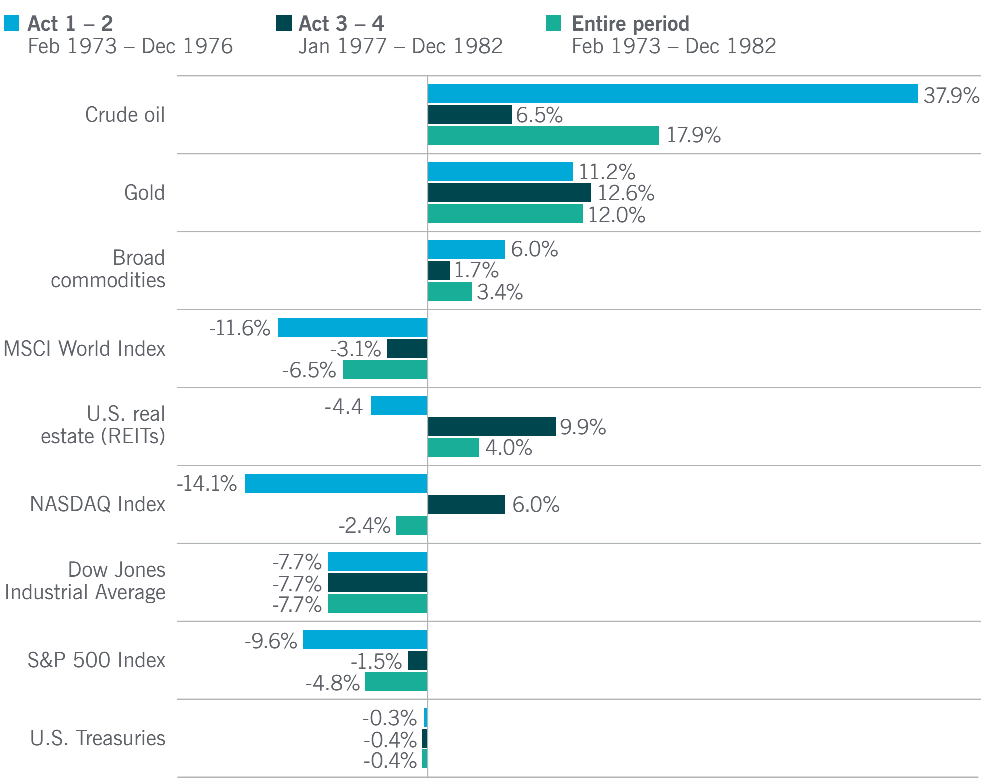
FIGURE 2: WINNERS AND LOSERS IN THE STAGFLATIONARY '70S

Annualized real return: 1973 – 1982 (%)



Data source: Bloomberg L.P. **Representative indexes: U.S. Treasuries:** Bloomberg US Treasury Total Return Unhedged USD; **S&P 500 Index:** S&P 500 Index; **Dow Jones Industrial Average:** Dow Jones Industrial Average; **NASDAQ Index:** NASDAQ Composite Index; **U.S. real estate (REITs):** FTSE NAREIT All Equity REITS Total Return Index; **MSCI World Index:** MSCI World Index; **broad commodities:** S&P GSCI Total Return CME; **gold:** XAUUSD Spot Exchange Rate – Price of 1 XAU in USD; **crude oil:** Bloomberg Crude Oil Historical Price.

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Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.

Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

For more information, please visit nuveen.com.

Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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A word on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

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