

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

In search of a motto for inflation nation

Bottom line up top:

E pluribus inflation. Fed policy, surging oil prices, Russia/Ukraine — these multiple drivers of recent market volatility are closely intertwined with inflation, arguably the most dominant source of investor angst in these turbulent times. Part of what makes inflation so challenging is how difficult it is to forecast. Historically, economists, consumers and markets have tended to get it wrong (Figure 1).

“When you come to a fork in the road, take it.” Yogi Berra’s famous advice aptly summarizes the dilemma for those attempting to predict the path of inflation. While many scenarios are possible, including “d. none of the above,” here are three currently being debated in the marketplace:

- a. Rapid descent.** Monetary tightening results in a dramatic near-term slowdown in economic activity, causing the Fed to reverse course.
- b. Not so fast.** A more benign outlook. Data will show inflation peaked in March. The rate of increase eases as demand fades, supply shocks begin to recede and base effects turn favorable. Fed tightening is steady but not excessive, clearing the runway for a soft landing.
- c. Up, up and away.** Probably the worst-case scenario, this path foresees persistently elevated inflation that a behind-the-curve Fed can’t rein in. More, larger and ultimately fruitless rate hikes lead to a much higher “neutral” rate and potentially kill the recovery.

Even the most seasoned investors would be hard pressed to forecast inflation with pinpoint accuracy. But we can use data, experience and judgment to estimate the probability of given scenarios coming to pass — and suggest which asset classes are best-suited to each.

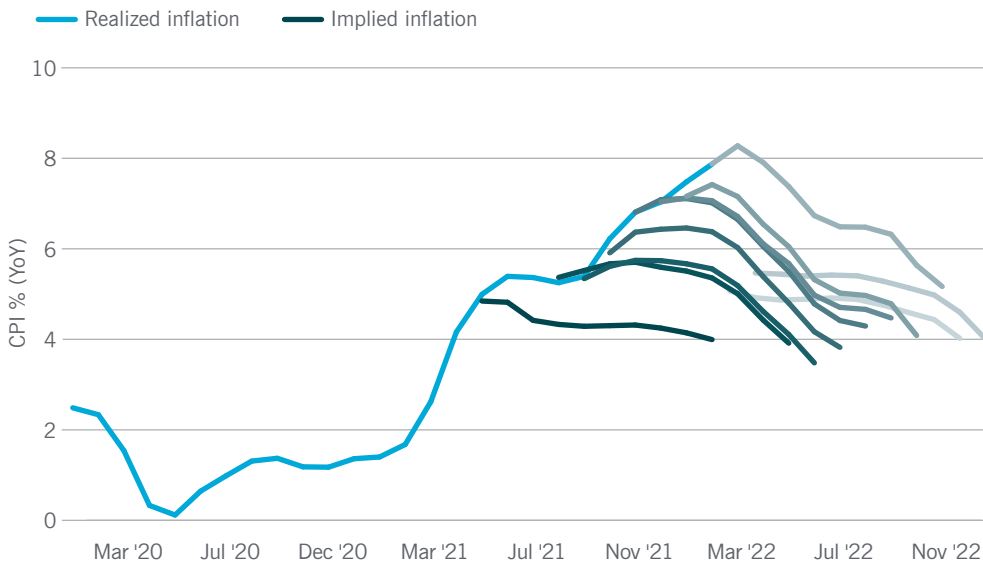


Saira Malik, CFA
Chief Investment Officer

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.

FIGURE 1: MARKET PREDICTIONS OF INFLATION HAVE CONSISTENTLY BEEN TOO LOW



Data source: Credit Agricole. Based on inflation-based swaps implied CPI inflation rates.

Portfolio implications

Possibility, not inevitability. We continually debate different potential near-term scenarios and their likelihood of occurring, and how various investments might perform. Figure 2 shows our framework for these discussions and our current assessments, admittedly a blend of art and science.

- Despite recent market angst over yield-curve inversion, we remain confident that a near-term recession is not in the cards, based on several indicators: positive real corporate profits growth, low and falling unemployment, and strong corporate and household balance sheets. These factors inform our expectations of a soft economic landing and still-constructive view on risk assets, while maintaining that the best hedge against near-term uncertainty is portfolio diversification focused on long-term outcomes.
- If a near-term recession causes the Fed to reverse its tightening course, we would expect rate-sensitive assets, including longer-duration stocks, to retrace their Q1 losses versus more cyclical counterparts.
- In a stagflation scenario, financial assets might struggle as the Fed aggressively hikes to control inflation. As we saw in 1980, a potential silver lining could be an eventual generational buying opportunity for fixed income as nominal yields rise and inflation begins to fade.

We also acknowledge that while history might rhyme, it rarely repeats, making near-term forecasting a humbling exercise. It's the "unknown unknowns" — unforeseen events that can't be priced in — that have delivered the greatest market shocks.

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FIGURE 2: THERE'S NO CRYSTAL BALL, BUT THE ODDS STILL FAVOR DIVERSIFIED, LONG-TERM INVESTORS

| RECESSION Growth and inflation decline rapidly | SOFT LANDING Slower but still strong real growth, with lower inflation | STAGFLATION Inflation remains high and real growth declines |
|--|--|---|
| Fed reverses course | Fed hikes to "neutral" rate | Fed hikes past "neutral" rate |
| Rate-sensitive assets recover | Rate-sensitive asset returns muted | Rate-sensitive assets struggle, then eventually outperform |
| Earnings estimates weaker | Earnings estimates higher | Earnings estimates weaker |
| Stock P/Es mixed-higher Higher quality credit spreads tighter | Stock P/Es mixed Credit spreads stable-tighter | Stock P/Es fall Credit spreads wider |
| Commodities and productive real assets struggle | Productive real assets outperform | Commodities and productive real assets outperform |
| Nuveen CIO odds = ~10% | Nuveen CIO odds = ~50% | Nuveen CIO odds = ~10% |
| <p><i>"Unknown unknowns"</i> <i>(a different outcome from any of the above)</i> <i>Nuveen CIO odds = ~30%</i></p> | | |

Source: Nuveen Portfolio Strategy. For illustrative purposes only.

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About Nuveen's Global Investment Committee

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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