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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Food and shelter inflation: The basics take a bigger bite

Bottom line up top:

The sticker shock for groceries and rent could be with us for a while. Prices for these bare necessities climbed sharply over the past year (Figure 1), helping push headline inflation to decades-high levels:

- In May, the CPI food component marked its first 12-month increase of 10% or more since March 1981, propelled by labor and ingredient shortages in food supply chains, higher energy and transportation costs, and surging prices for wheat and other agricultural commodities.
- Rents have spiked as scant supply has met surging demand, driven in part by would-be homebuyers priced out of the housing market thanks to a similar supply crunch, soaring residential construction costs and higher mortgage rates. The shelter component of CPI, which reflects rental prices, rose more than 5% compared to May 2021 — the largest year-over-year jump since February 1991.

If these trends upend spending patterns, consumer contributions to economic growth could weaken. So far, consumers have maintained spending, even as food and shelter claim a bigger share of their budgets. To do this, they've saved less and borrowed more. Whether this is sustainable remains to be seen, but last week's negative surprise in retail sales for May (and downward revision for April) could signal potential cracks in the strong-consumer narrative. We'll learn more when personal consumption expenditures — more comprehensive than retail sales — are released at the end of June.

Saira Malik, CFA
Chief Investment Officer

On behalf of Nuveen's Global Investment Committee

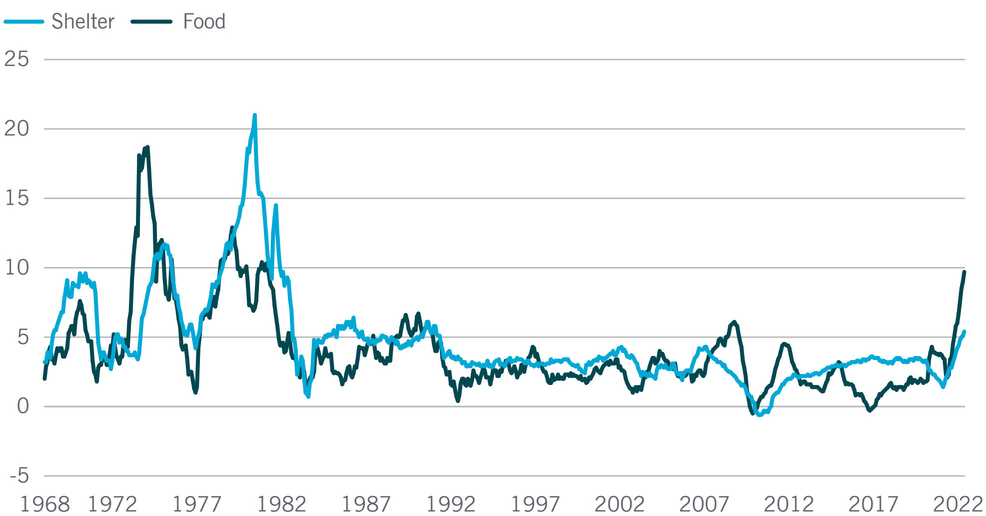
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's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

Hedging inflation in portfolios has become more challenging. Asset classes traditionally seen as go-to investments during inflationary periods, such as TIPs, generally haven't been effective this year. We're taking a closer look at other potential opportunities within fixed income, equities and real assets that we believe can offer some inflation protection and may warrant an allocation.

As inflation in bare necessities like food and shelter runs high, consumers may be forced to cut back other spending. We're watching this trend closely.

FIGURE 1: INFLATION CONTINUES TO RUN HIGH FOR FOOD AND SHELTER

Inflation change, year-over-year (%)



Data source: Federal Reserve Bank of St. Louis, 31 May 2022.

Portfolio considerations

Combating inflation is tricky when the Fed is tightening. Increasing costs of essentials like food, transportation and shelter will continue to pressure global central banks to act boldly to restore price stability. As of Friday's close, futures are now implying a fed funds rate just shy of 4% in mid-2023, up from 3% only two weeks ago. This rapid change in expectations has been felt across equities, credit and rates alike, reminding allocators how quickly asset correlations can rise during severe, liquidity-driven selloffs.

What to do now? When liquidity is scarce, those who are in a position to put cash to work can find themselves well compensated. Consider U.S. high yield bonds, for example. While not a typical inflation hedge, investors with long time horizons and high single-digit return targets might find starting yields north of 8% for the broad index and 7% on the BB rated segment attractive. Within equities, we have a high conviction in infrastructure, which includes many companies that are better positioned to pass increased operating costs through to end users.

Historically speaking, strategic allocations should be designed to generate returns that over time will outpace long-term inflation. There's no greater threat to achieving this objective than severe portfolio drawdowns that deplete one's capital base, given that it takes an 10% return to recover from a 9% drawdown, and a 100% return to recover from a 50% drawdown. That means owning broad equities (which outpace inflation over the long term, but can struggle in high-inflation periods) alongside productive, cash-flow-generating real assets. While no two macro environments are exactly alike, Figure 2 segments historic returns into four different inflation regimes. Although commodities, specifically crude oil futures, might be the most direct inflation hedge, they can also be volatile and prone to downside swings in more disinflationary environments.

Commodities often shine during periods of high inflation, but over the long term tend to introduce significant portfolio volatility.

FIGURE 2: PRIVATE REAL ASSETS AND COMMODITIES HAVE PERFORMED WELL IN INFLATIONARY ENVIRONMENTS

	Disinflation	Below trend inflation	Above trend inflation	High inflation	All periods	Volatility
Percent of periods in each regime (quarterly data, 31 Dec 1994 - 31 Mar 2022):	*10.09%*	*41.28%*	*40.37%*	*8.26%*		
PRIVATE REAL ASSETS						
NCREIF Total Return (%) Farmland Index	11.00%	10.34%	11.25%	13.66%	11.05%	6.13%
NCREIF Total Return (%) Timberland Index	4.84%	7.18%	6.18%	12.50%	6.96%	4.85%
Cambridge Infrastructure Index	0.60%	4.86%	5.73%	10.62%	5.24%	10.01%
NCREIF Property Index	-2.97%	10.92%	10.15%	15.08%	9.46%	4.22%
PUBLIC REAL ASSETS						
FTSE NAREIT All Equity REITS Total Return Index	-0.12%	11.48%	14.64%	4.60%	10.92%	19.52%
S&P Global Infrastructure Total Return Index	2.77%	7.86%	7.72%	5.61%	7.09%	14.70%
COMMODITIES						
Bloomberg Commodity Index Total Return	-20.44%	5.69%	3.43%	24.50%	3.20%	17.49%
Bloomberg WTI Crude Oil Subindex Total Return	-49.30%	-2.55%	20.72%	55.06%	3.36%	37.09%
Bloomberg Gold Subindex Total Return	9.70%	4.66%	4.23%	14.57%	5.77%	12.95%
STOCKS & BONDS						
MSCI World Net Total Return USD Index	5.67%	13.64%	4.95%	-2.11%	7.91%	16.95%
Bloomberg U.S. Treasury Inflation Notes TR Index Value Unhedged USD	4.67%	5.45%	4.85%	2.56%	4.89%	4.58%
Bloomberg U.S. Agg Total Return Value Unhedged USD	6.84%	6.72%	4.38%	-1.57%	5.08%	3.90%

Data sources: Bloomberg, NCREIF, Cambridge Associates, through 31 Mar 2022. **Past performance does not predict or guarantee future results.**

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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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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