

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Giving high yield credit sectors their due

Bottom line up top:

Balancing today's big risks — inflation, recession and earnings — is no small task. June's 9.1% CPI print was the latest inflation data jolt investors have had to absorb this year. The unwelcome reading points to another 75 basis point rate hike at the July Fed meeting, with the market pricing in a sizeable chance of a full 100 bps move. That should please investors who prioritize inflation-fighting, but may unsettle the “growth is slowing too fast” contingent worrying that the Fed will push the economy into recession—and recession risks have clearly increased since the start of the year. Meanwhile, as inflation continues to squeeze corporate profits, negative earnings revisions may pose the biggest risk to equities in the second half of 2022.

We have a relative preference for high yield credit sectors.

Nuveen's Global Investment Committee believes credit assets, specifically high yield bonds and senior loans, currently offer a more favorable risk/reward tradeoff than equities:

- Their yields look attractive.
- Credit fundamentals appear strong. We don't expect defaults to rise materially, even in a recession, as debt burdens aren't excessive and low financing rates have been locked in.
- Given today's starting point, high yield bonds and loans likely have less downside potential than equities while offering high current income.



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.

Portfolio construction considerations

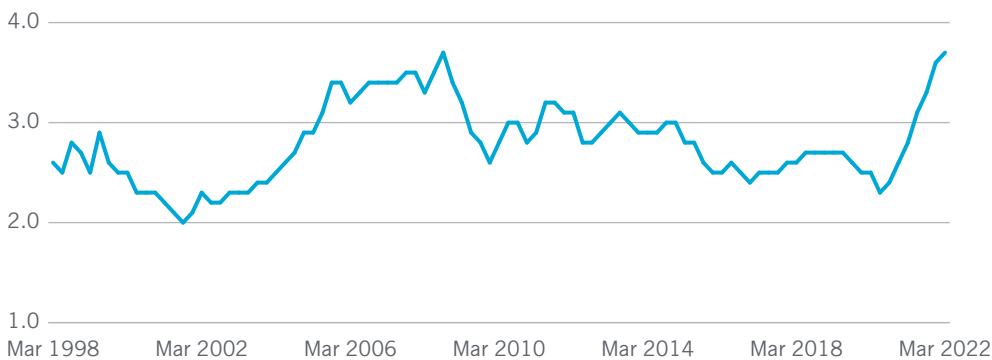
Credit fundamentals support the case for high yield and loans. In the case of high yield, **interest coverage** is at its highest level since 2008 (Figure 1). This means borrowers are generating operating profits that cover roughly four times their annual interest expense, making them well positioned for a potential recession.

Additionally, **issuers have locked in low interest costs for several years:** Figure 2 shows the percentage of current debt outstanding that matures each year in the high yield and loan markets, with 75% of that debt maturing after 2025. This not only mutes the impact of any increase in interest expense, but also helps companies avoid large principal payments. Lastly, we think today's **historically low default rates** are unlikely to rise above current market expectations of about 5%.

We see more near-term risks for equity markets than we do for fixed income credit sectors.

FIGURE 1: HIGH YIELD IS WELL POSITIONED FOR A SLOWDOWN

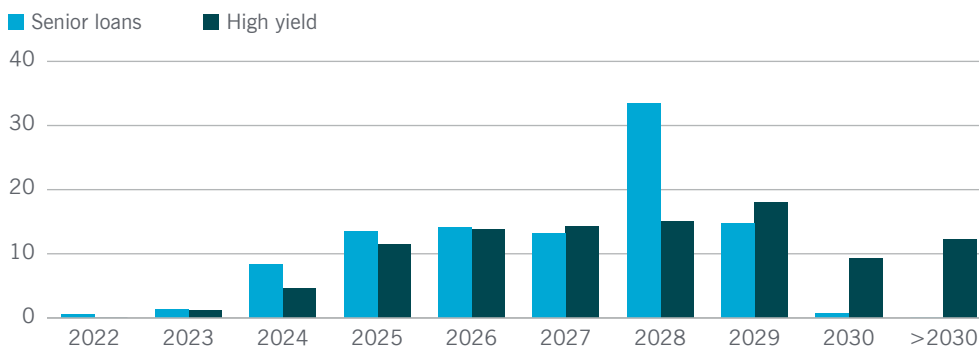
Interest coverage ratio



Data source: Bloomberg, L.P., March 1998 to March 2022. Data depicts the ratio of interest expense covered by the annual operating profits of the Bloomberg Corporate High Yield Index.

FIGURE 2: THE “WALL OF MATURITY” SHOULD SUPPORT HIGH YIELD AND LOANS

Percent of maturing debt outstanding by year (%)



Data source: Bloomberg, L.P., as of 13 July 2022. **Representative sectors and indexes: senior loans:** All outstanding loans available via Bloomberg that are greater than \$50 million in initial value and that are below investment grade. **high yield:** Bloomberg Corporate High Yield Index.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

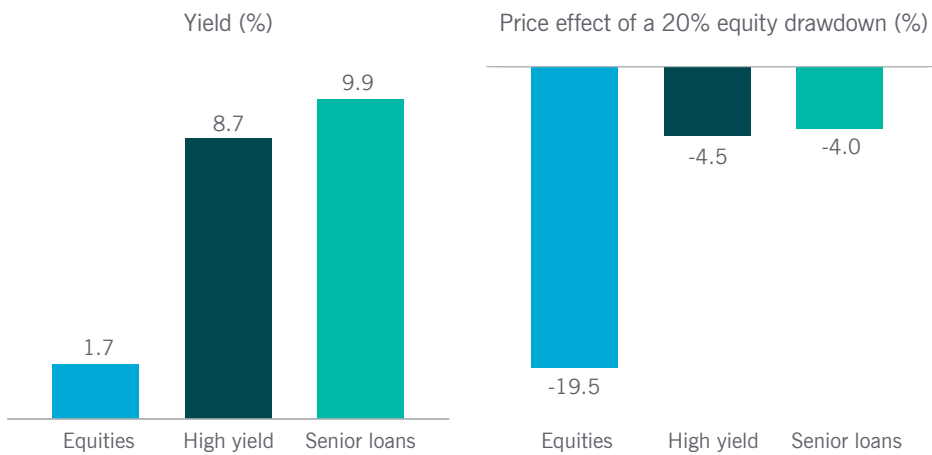
We recognize that credit sectors aren't immune to spread widening as growth slows. And over the long term, we expect equities to provide higher upside. But **stocks appear more vulnerable to near-term risks**, particularly amid the uncertainty of the current earnings season.

We recently "stress tested" these asset classes and found that both high yield bonds and senior loans have less downside price sensitivity than equities, with coupon income providing a much greater cushion than equity dividend yields (Figure 3). On balance, investors seeking to position portfolios in the current fraught environment may find that a relative focus on **credit over equities offers a compelling risk/reward opportunity**.

Attractive yields, solid fundamentals and prospects for downside protection make high yield and loans look especially compelling today.

FIGURE 3: CAPTURING YIELD AND MANAGING DOWNSIDE

Current yields and price impacts of a 20% drop in equities



Data source: Nuveen and Bloomberg, L.P., as of 15 July 2022. Price declines are based on a hypothetical stress test of the impact of a 20% equity market decline. **Past performance does not predict or guarantee future results.** Representative sectors: equities: S&P 500 Index; high yield: Bloomberg Corporate High Yield Index; senior loans: Credit Suisse Leveraged Loan Index.

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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Important information 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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