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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Is fixed income a phoenix set to rise?

Bottom line up top:

It's been a crash-and-burn year for fixed income. This year's dismal bond market returns have been unprecedented, as in the case of the Bloomberg U.S. Aggregate Index, which suffered its worst year-to-date loss since inception in 1976 (Figure 1). These results are all the more jarring given the 40-year downtrend in interest rates that preceded them. The discordant tone was set early in 2022, with macro forces serving up a volatile cocktail of low starting yields, the highest inflation in decades and a rapid shift to ultra-hawkish monetary policy — all of which has left investors shaken, not stirred.

Some investors have been hit harder than others. The misery has been widely shared, from advisors reimagining their clients' traditional 60/40 portfolios in a transformed fixed income landscape to institutions gauging how much higher yields must climb to compensate for the risk taken. Investors in or near retirement are among the most challenged, sometimes experiencing double-digit declines in their "conservative," bond-heavy investment portfolios.

Where there's smoke, there may be opportunity. In the past we've seen fixed income markets rebound impressively after bad years. For example, the U.S. Aggregate Index realized a -2.5% loss in 1994, at the time its worst performance on record — only to be followed by one of its best years in 1995. Of course, that environment was vastly different than today, with unique economic and market drivers at work. If 2022 has taught us anything, it's that precedent and experience can only go so far — so caution remains a must.

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.

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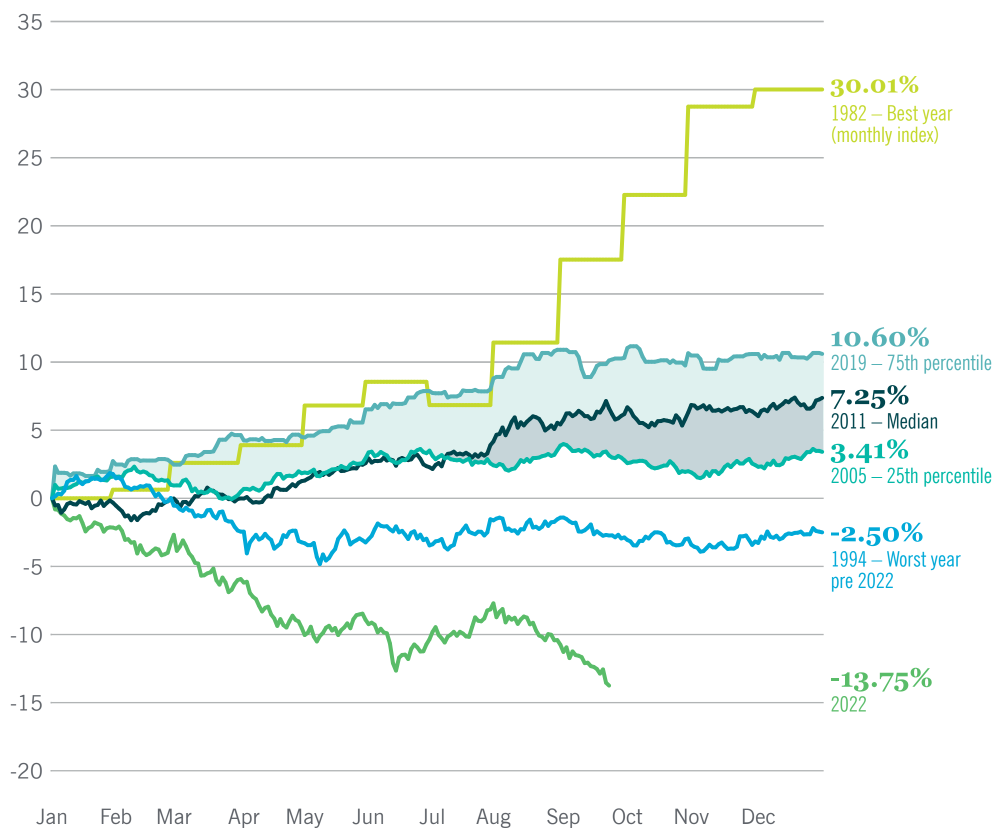
If 2022 has taught us anything, it's that precedent and experience can only go so far.

While we're not calling for a similar market rebound in 2023, we do think select pockets of opportunity may begin to present themselves. Here we offer specific ways in which investors may position their fixed income allocations as the smoke starts to clear.

FIGURE 1: A YEAR LIKE NO OTHER FOR FIXED INCOME INVESTORS

U.S. Aggregate Index losses are over four times more than the previous worst calendar year (%)



Data source: Bloomberg L.P., 23 Sep 2022. **Past performance does not predict or guarantee future results.** As measured by total returns of the Bloomberg U.S. Aggregate Index.

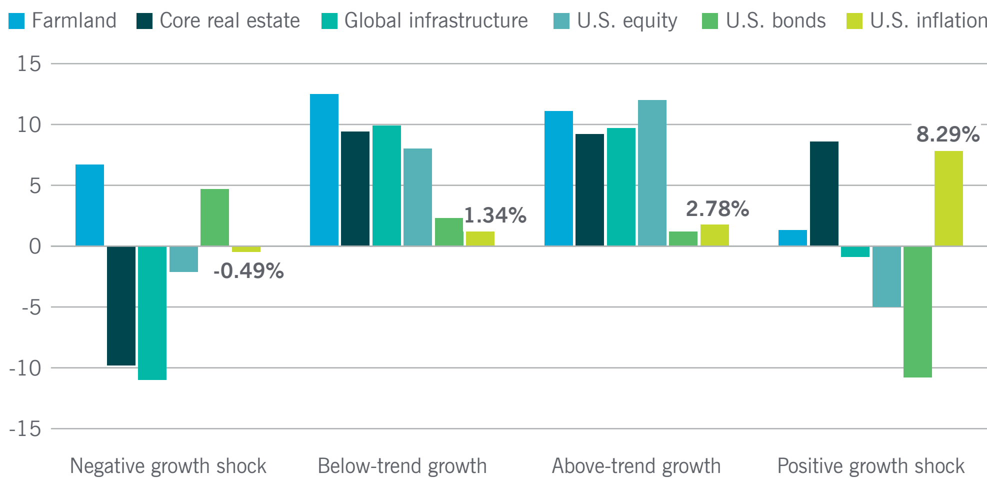
Given 2022's sharp rise in Treasury yields, we believe dollar-cost averaging into rate-sensitive bonds is a sound approach. When allocating from cash or short-term bonds, this approach would be a cautious way to slowly extend duration. For balanced portfolios, where fixed income is meant to cushion against equity market volatility during deflationary shocks, a 3- to 5-year duration range balances income generation with lower volatility than in the longer-maturity market segments. Additionally, current yield and spread levels across fixed income are bright spots that should not be ignored. Two areas that we like — high yield and leveraged loans — are yielding 9.50% and 10.87%, respectively. With more near-term volatility likely, the income received should provide a return cushion against any negative price action resulting from spread widening.

Further highlighting the wisdom of maintaining fixed income allocations in diversified portfolios, Figure 2 shows that core fixed income historically has tended to generate real returns during "left tail" growth shocks, when nominal GDP declines substantially below trend. In contrast, risk assets tend to falter under such circumstances. We expect this relationship to hold if inflation starts to fade in 2023.

We believe that dollar-cost averaging into rate-sensitive bonds is a sound approach.

FIGURE 2: CORE FIXED INCOME HAS GENERATED REAL RETURNS DURING NOMINAL GROWTH REGIMES

Index returns during economic shock scenarios (%)



Data source: Bloomberg L.P. 29 Sep 2022. **Past performance does not predict or guarantee future results.** Quarterly index return data from Dec 2004 to Jun 2022. "**Negative growth shock**" represents quarters where trailing 4Q U.S. nominal GDP growth is a standard deviation below the trailing 40Q average growth. "**Positive growth shock**" represents quarters where trailing 4Q U.S. Nominal GDP growth is a standard deviation above the trailing 4Q average growth. "**Below-Tend**" and "**Above-Trend**" are the remaining periods, and represent when trailing 4Q U.S. nominal GDP growth is below or above the trailing 4Q average growth. **Representative indexes: farmland:** NCREIF Total Return (%) Farmland Index; **core real estate:** NCREIF Fund Index Open End Diversified Core (ODCE) Total Index Value; **global infrastructure:** S&P Global Infrastructure Total Return Index; **U.S. equity:** Russell 1000 Index Total Return; **U.S. bonds:** Bloomberg US Agg. Total Return Value Unhedged USD; **U.S. inflation:** Headline CPI.

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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