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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Quality transcends growth versus value

Bottom line up top:

Comparing growth against value is a longstanding tradition. The discussion typically focuses on which equity investment style will outperform in what type of environment. Historically, growth has tended to perform best in weak, but positive, economic growth scenarios, and usually in the 12 months leading up to a recession. In contrast, value has proved to be more cyclical, outperforming during periods of accelerating and above-trend economic growth. History also shows that value has generally beaten growth in the 12 months after core CPI inflation peaks. But is this the best lens for viewing today's challenging market landscape?

Bucking the trends. During the bear market of 2022, neither growth nor value has behaved as history might suggest. In part, this is because the "abnormal normalization "of conditions in the post-Covid era has forced the U.S. Federal Reserve to prioritize inflation over economic growth to an extreme degree. The increased likelihood of a recession is primarily a function of the Fed's contractionary monetary policy and not part of a typical economic cycle.

A shift in emphasis is called for. Rather than try to divine how growth and value might perform heading into year-end and 2023, investors may be better served by focusing on other factors to inform their equity allocation decisions. In particular, quality characteristics, like those shown in Figure 1, have delivered consistently strong returns this year and over longer periods. In our view, these factors are likely to outperform should the U.S. economy enter a recession. Dividend growers exhibit these quality attributes — an area of the market we explore further in the following analysis.

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: DON'T QUIBBLE WITH QUALITY

Quality factors have outperformed over time

Style	Factor	YTD	5 years	10 years
Growth	1-yr earnings growth	6.7 %	-2.5%	10.6 %
Value	Book value to price	16.4 %	0.6 %	0.3 %
Quality	Return on assets	2.9 %	55.8 %	45.3 %
	Net profit margin	29.6 %	6.8 %	34.4 %
	Net debt/EBITDA*	4.3 %	16.2 %	40.6 %

Data source: Bloomberg L.P. 03 Nov 2022. **Past performance does not predict or guarantee future results.** Reference universe is the Russell 3000 Index. Factor performance is measured as the relative performance of quintile 1 less quintile 5. The quintiles are formed by ranking the universe on each factor and splitting it into 5 groups of equal-weighted single equities. Quintile 1 has the highest raw score and quintile 5 the lowest. *Inverted so that the positive returns indicate the performance of low raw scores, which we consider to indicate high quality, e.g. lower debt-to-assets is considered higher quality than high debt-to-assets.

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Portfolio considerations:

Rumor has it that Albert Einstein once described compound interest as "the most powerful force in the universe." While the attribution of that quote is dubious, the underlying concept about the power of compounding is sound. For equity investors, the compounding of dividends harnesses the same kind of power. As shown in Figure 2, U.S. dividend growth strategies have not only generated above-market performance over the past 20 years, but have also done so while exhibiting defensive attributes. This is evident from their higher annualized returns and lower beta profile relative to the broad market. Additionally, dividend growth stocks have a favorable upside (92.6%) versus downside (79.8%) capture that has allowed the strategies to win by not losing. Investors seeking to cushion downside exposure given a looming recession, yet also wanting to participate in the eventual economic recovery, may find dividend growth to be a particularly compelling equity allocation.

FIGURE 2: DIVIDEND GROWERS OUTPERFORMED WITH LOWER BETA

10-year performance statistics

20 years	Annualized return	Alpha	Beta	Up capture ratio	Down capture ratio
U.S. dividend growth	11.3	2.4	0.87	92.6	79.8
U.S. quality	10.5	1.4	0.91	94.9	87.7
S&P 500 Index	9.8	0.0	1.00	100.0	100.0

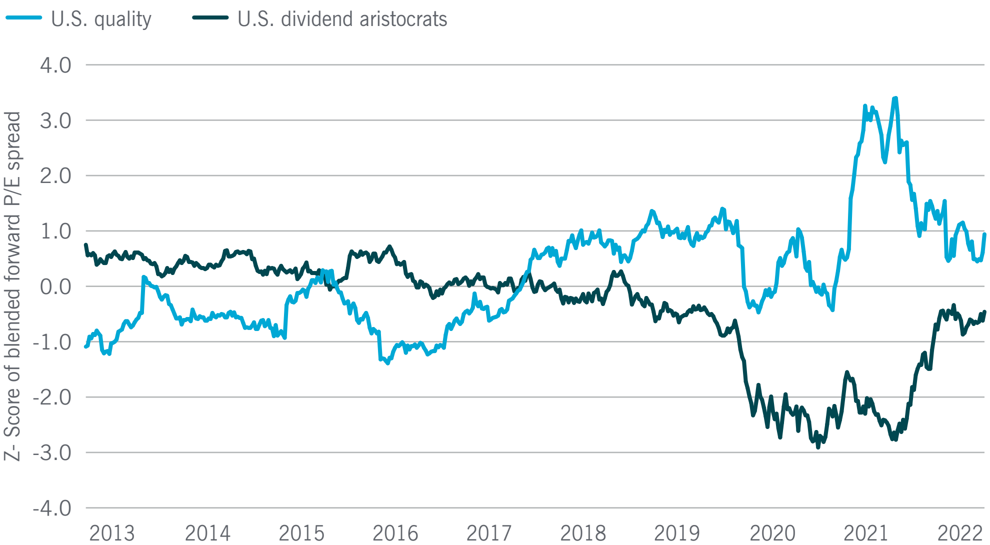
Data source: Morningstar. Data are monthly from 01 Nov 2002 to 31 Oct 2022. **Past performance does not predict or guarantee future results.** Note: U.S. dividend growth is represented by the S&P 500 Dividend Aristocrats Index. U.S. quality reflects the MSCI USA Quality Index. Alpha = a measure of excess return vs. a benchmark. The higher the alpha, the greater the degree of outperformance vs. the benchmark. Beta = a measure of volatility vs. a benchmark. A beta of <1.0 indicates less volatility than the benchmark. Upside capture compares performance against a benchmark during periods when the benchmark's performance is positive. Downside capture compares performance against a benchmark during periods when the benchmark's performance is negative.

Better than quality at a more favorable price. U.S. quality equities that reflect the fundamental metrics shown in Figure 1 have performed similarly to dividend growth. But valuations for dividend growers are currently cheaper relative to their history, while quality names are more expensive (Figure 3). In assessing which defensive, quality-related equity themes or strategies may be best positioned for success in today's environment, investors would be well-served to consider lower-priced assets that provide a valuation tailwind, while also avoiding the potential unwinding of valuation premiums among more expensive options.

Investors would be well-served to consider lower-priced assets that provide a valuation tailwind.

FIGURE 3: DIVIDEND GROWERS ARE ATTRACTIVELY PRICED

Relative valuation of quality styles



Data source: Bloomberg L.P., 28 Oct 2022. **Past performance does not predict or guarantee future results. Z-score is the number of standard deviations between the current spread level and the average spread level.**

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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