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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Opportunities for when the Fed's recession knocks

Bottom line up top

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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.

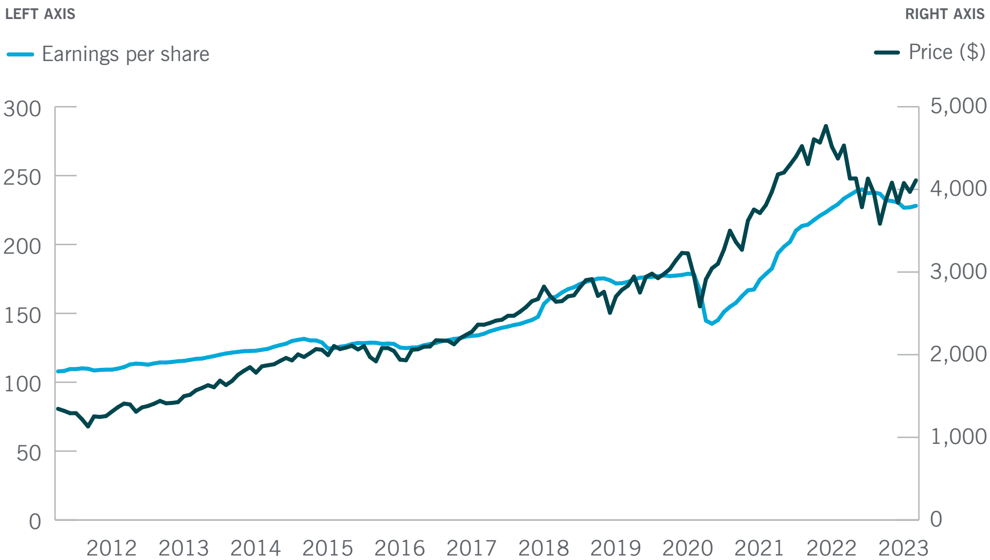
As the U.S. Federal Reserve readies for what we think will be its last climb up Rate Hike Mountain, weary investors have already traded in their hiking boots for more comfortable footwear, eyeing a course they hope will be downhill from here. The Fed's May meeting is merely hours away as we write, with all eyes on the next rate decision and any guidance on future policy. And although the March print showed the Core Personal Consumption Expenditure Index — the Fed's preferred inflation barometer — remains higher than the central bank would like, we think we may be approaching peak rates.

With that, we expect Fed Chair Jerome Powell to announce a 25 basis points rate increase this week, but then pause on the Fed's 13-month, anti-inflation tightening campaign. We foresee a mild recession ahead, driven by this aggressive hiking cycle, but we reject the old market mantra, "Sell in May and go away." Instead, we continue to preach "stay invested," informed by the relative strength of corporate earnings and the underlying economy, combined with encouraging historical data about investment performance following a Fed pause.

While 2023 earnings forecasts have been revised modestly downward (Figure 1), equity valuations are rebounding on potential monetary policy changes propelled by what may be the most anticipated recession of all time. While equity investors are rooting for rate cuts by year end, rate stability may prove to be the strongest catalyst for positive returns across a broad swath of asset classes (Figure 2).

FIGURE 1: STOCK VALUATIONS HAVE IMPROVED DESPITE LOWERED EARNINGS ESTIMATES

S&P 500 Index earnings-per-share and price



Data source: FactSet, 31 May 2011 to 31 Mar 2023. **Performance data shown represents past performance and does not predict or guarantee future results.**

We don't subscribe to the old adage, "Sell in May and go away."

Portfolio considerations

This anticipated environment of interest rate stability could (we hope and expect) create attractive opportunities in the taxable fixed income arena. In particular, we favor spread sectors that offer compelling yields that should avoid excessive spread widening — even during the mild recession we anticipate will occur later in 2023.

High hopes for high yield. U.S. high yield corporate bonds are now yielding 8.5% with a duration of less than four years, making them less sensitive to spread widening compared to other fixed income investments. While history may not repeat itself, we think the end of the Fed's current cycle could be another "pause that refreshes."

Preferring preferreds. Another attractive spread sector is preferred securities, although this preference is based less on rate stability and more on recent market moves that have created value. March's banking sector turmoil led preferred spreads to widen by 90 bps. Yet the contagion risks that many initially feared did not materialize, and preferred spreads have retraced only about a third of that widening.

> *A more stable interest rate environment should provide a tailwind for multiple areas of the market.*

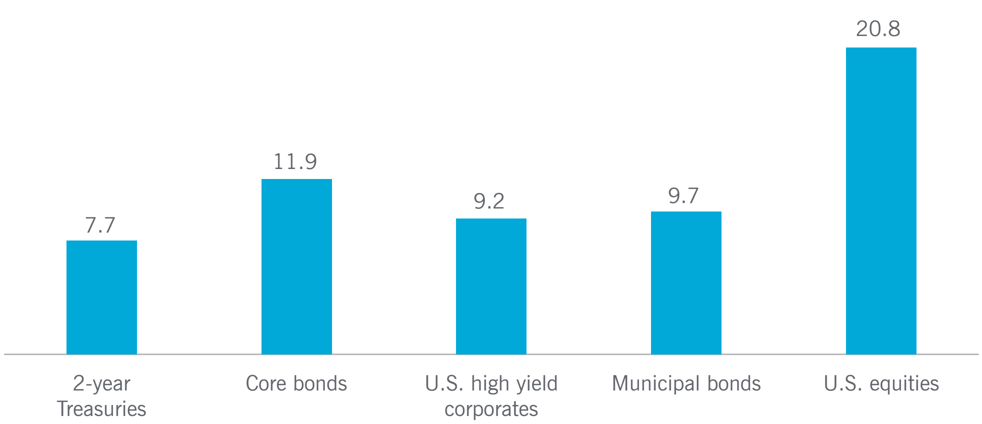
Munis win on appeal. The municipal bond market tends to be among the most vulnerable to rate volatility, as the asset class is prone to outflows during uncertain times, as we saw in 2022. Munis have rebounded this year, with investors rediscovering their appeal as rates slowly stabilize. Within the municipal landscape, we prefer pairing credit risk with duration risk. Municipal credit has strong underlying fundamentals, and a steeper yield curve relative to Treasuries favors longer-duration exposure.

Dialing up dividend growth and infrastructure. Outside of fixed income, while equities have typically rallied after a Fed pause, we continue to favor defensive exposure and sectors that should be relatively resilient if inflation remains stubborn. We emphasize dividend growth and infrastructure equities, both of which tend to perform relatively well during economic slowdowns and recessions. Additionally, infrastructure should be well-insulated from elevated debt costs and inflation.

Prioritizing private credit and real estate. In private capital markets, we prefer allocating to income-producing asset classes with the potential for downside protection. In particular, we see compelling opportunities in select areas of private credit and private real estate.

FIGURE 2: ROOM TO RUN AFTER THE FED PAUSES?

Average one-year return following the last five rate hike cycles (%)



Data source: Bloomberg, L.P. Time periods reflect the average of one-year returns starting from the last Federal Reserve rate hike (24 Feb 1989; 01 Feb 1995; 16 May, 2000; 29 Jun 2006; 20 Dec 2018). **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: 2-year Treasuries:** ICE BofA 2-Year U.S. Treasury Index; **core bonds:** Bloomberg U.S. Aggregate Bond Index; **U.S. high yield corporates:** Bloomberg U.S. High Yield Corporates Index); **municipal bonds:** Bloomberg Municipal Bond Index; **U.S. equities:** S&P 500 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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