

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A durable case for duration

Bottom line up top

Is the Fed's inflation-fighting epic nearing its final chapter?

The magical book at the center of 1980s fantasy film *The Neverending Story* tells the tale of a young warrior who battles the Nothing, an evil force intent on destroying the land of Fantasia. A similar title and plot summary could easily apply to U.S. Federal Reserve Chair Jerome Powell and his fellow policymakers' relentless quest to stamp out the scourge of inflation. Of course, inflation isn't "nothing," and the potential collateral damage from the Fed's aggressively hawkish monetary policy — namely, a possible recession — might bring this very real economic story to a less-than-happily-ever-after conclusion.

But while investors have been preparing their portfolios since early 2022 against the so-called "most anticipated recession of all time," the dreaded downturn has yet to materialize. In fact, market expectations currently favor a soft-landing narrative amid recent disinflationary trends and signs of gradually diminishing consumer strength, such as heavier debt loads (Figure 1). And August employment data revealed a slowdown in hiring, fewer job openings and an uptick in the unemployment rate, driven by an increase in the labor force participation rate. These factors collectively support the argument for an imminent pause in Fed rate hikes.

An inflation epilogue or sequel could complicate the story.

Our base case scenario continues to call for (1) one more 25 basis points (bps) rate increase in this cycle, either at the Fed's September or November meeting (we lean toward the latter), after which we expect



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.

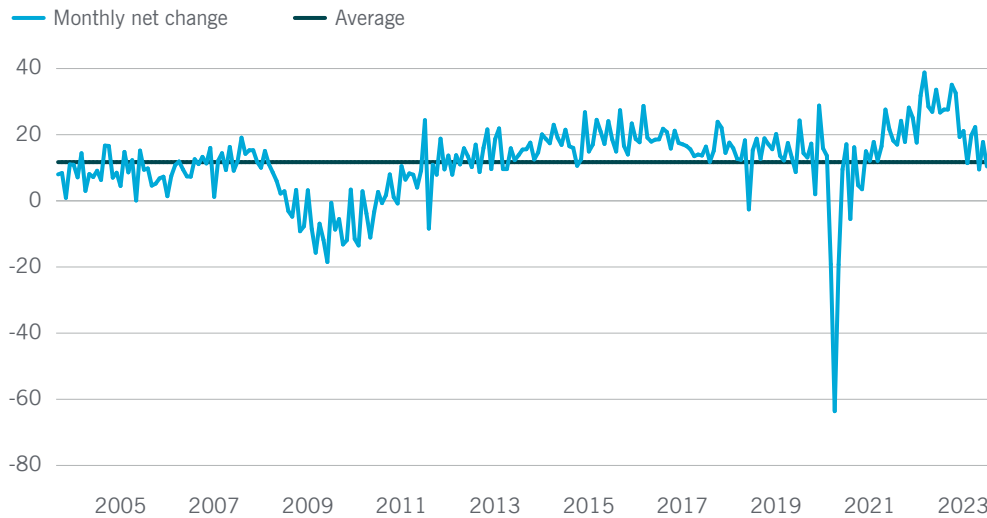
OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

policy rates to remain stable but elevated, likely through the end of next year; and (2) a soft landing or mild recession sometime in 2024. The plot could thicken if climbing oil prices continue, driving a rebound in overall inflation and prompting a vigilant Fed to hike more than once in the near to medium term.

FIGURE 1: CONSUMERS CONTINUE TO PILE ON HIGHER AVERAGE DEBT

U.S. Federal Reserve Consumer Credit Index, total net change (seasonally adjusted, \$B)



Data source: Bloomberg L.P., 08 Sep 2023. Performance data shown represents past performance and does not predict or guarantee future results.

Portfolio considerations

Given our perspective on moderating inflation and Fed policy, we believe yields — including the bellwether 10-year U.S. Treasury yield — have likely peaked for this interest rate hiking cycle. The 10-year yield has typically peaked within the last few months before a final Fed rate increase, which in this case we anticipate will occur no later than the first day of November. This backdrop informs our view that investors should consider closing duration underweights in taxable fixed income.

One way to do this is by adding to **investment grade corporate bonds**, which have relatively longer durations than the broader fixed income market. They are also currently yielding close to 6%, and defaults are expected to remain low. We also favor selectively taking on risk in other credit sectors like senior loans, emerging markets debt and preferred securities, although duration in these categories is lower than in corporate bonds.

The plot could thicken if climbing oil prices continue, driving a rebound in overall inflation and prompting a vigilant Fed to hike more than once in the near to medium term.

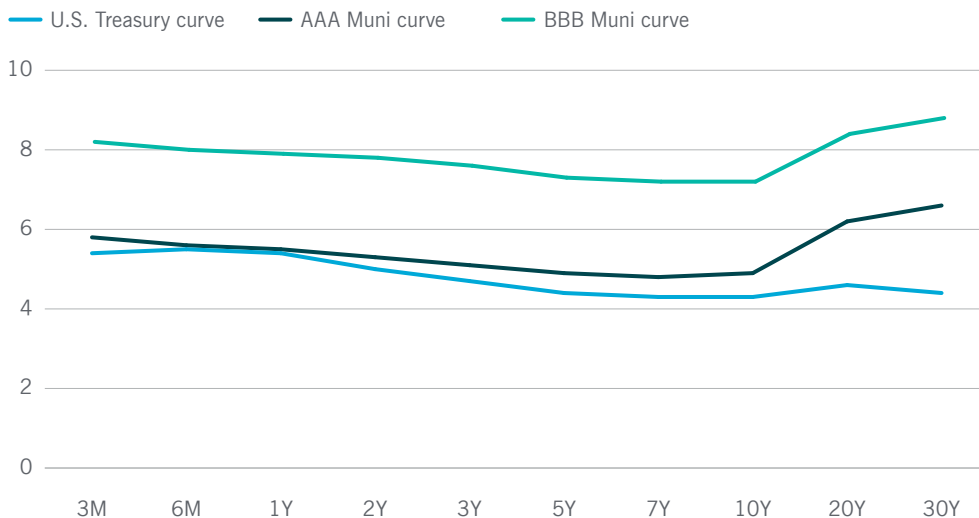
In the municipal bond space, we prefer a modestly overweight duration position, supported by an upward-sloping yield curve.

In the **municipal bond** space, we prefer a modestly overweight duration position, supported by an upward-sloping yield curve (Figure 2). AAA municipals are yielding more than Treasuries on a tax-equivalent yield basis across the curve. Additionally, we see attractive opportunities within the “up-in-quality” part of the municipal high yield market, which also offers longer duration. We expect credit spreads in this segment to remain stable, with defaults unlikely to rise in the medium term. BBB rated municipals are yielding about 2.5% more than their AAA municipal counterparts across short- and long-term maturities, which we find compelling.

Muni fundamentals remain sound. Rainy day funds (savings/reserves) for municipalities, for example, sit at historic highs. State governments are entering fiscal year 2023 with \$159 billion in rainy day funds, more than double their pre-pandemic level, offering significant budgetary flexibility. At the same time, a weak issuance calendar should keep muni supply low, a supportive technical for the asset class.

FIGURE 2: MUNICIPAL YIELD CURVE FAVORS EXTENDING DURATION

Treasury curve vs taxable-equivalent muni curves (%)



Data source: Bloomberg L.P., 05 Sep 2023. Performance data shown represents past performance and does not predict or guarantee future results. The taxable-equivalent yield (TEY) is based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income (the Net Investment Income Tax). Individual tax rates may vary.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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.

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain “forward-looking” information that is not purely historical in nature.

Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments.

Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk. 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. Bond insurance guarantees only the payment of principal and interest on the bond when due, and not the value of the bonds themselves, which will fluctuate with the bond market and the financial success of the issuer and the insurer. No representation is made as to an insurer's ability to meet their commitments.

This information should not replace an investor's consultation with a financial professional regarding their tax situation. Nuveen is not a tax advisor. Investors should contact a tax professional regarding the appropriateness of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Nuveen, LLC provides investment services through its investment specialists. This information does not constitute investment research as defined under MiFID.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

844635 GWP-3103226PG-E0923P