CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Passing the torch to a new generation of income

Bottom line up top

Interest rate reality sets in. Last week markets grappled with hotter-than-anticipated U.S. inflation data, with both the Producer and Consumer Price indexes for September surprising to the upside. Energy and core services ex-energy (including stubbornly sticky shelter costs) continued to confound investors who've been champing at the bit for relief from the U.S. Federal Reserve's historically restrictive monetary policy (Figure 1). But the road to the Fed's 2% inflation target will likely remain bumpy and prone to unexpected turns. Investors would be well-advised to rein in their rate optimism and prepare for periodic spikes in volatility. This includes accepting, however reluctantly, the higher-for-longer interest rate environment — and positioning portfolios accordingly. In our view, even if the Fed is done hiking for 2023, it's unlikely to pivot to rate cuts until the second half of 2024 at the earliest.

Stop hiding and start seeking. As investors flee risk assets for the safety of cash and cash equivalents, allocations to money market instruments have reached a record high of roughly $5.5 trillion this year. Such assets have provided attractive yields and shielded investors from some of the volatility markets have faced over the past 18 months, but history shows that those benefits could soon fade once the Fed ends its hiking cycle. At the same time, longer-duration assets — particularly fixed income and alternatives — have historically outperformed following periods of dramatic spikes in short-term yields. Given the substantial declines in these asset classes since the Fed started raising rates in March 2022, their total return potential looks extremely attractive. What's more, the right mix of these investments may generate significant income while also reducing portfolio risk.

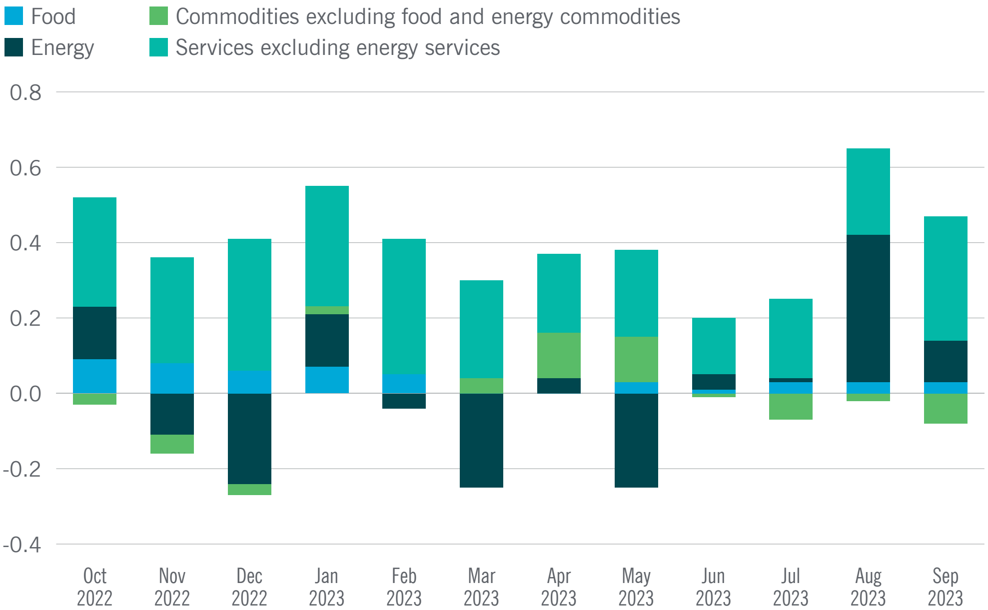
Saira Malik, CFA
Chief Investment Officer

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: SERVICES CONTINUE TO DRIVE INFLATION

Headline CPI inflation month-over-month (%)



Data source: Bloomberg L.P., 29 Sep 2023.

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Portfolio considerations

For investors, the uncertain interest rate and economic outlook heading into 2024 underscores the importance of maintaining a stable source of income with potential downside protection. With that in mind, we have developed representative examples of well-diversified income portfolios to meet different income needs.

One of these portfolios focuses on **nontraditional income**, which may be an attractive solution for investors comfortable with reduced daily liquidity and seeking less correlation to broad macroeconomic factors. It pursues income by balancing public and private assets for a smoother ride (Figure 2).

Private markets account for 35% of assets, resulting in a 5.7% yield with low volatility (3.9 standard deviation).

- **Private credit** offers an attractive risk-adjusted return profile, and its floating-rate structure protects against potentially higher interest rates.
- **Farmland** can serve as a hedge against elevated inflation, such as we've experienced over the past two years. And because farmland produces basic necessities, demand for the goods and services produced should be resilient during periods of economic weakening.
- **Core real estate** creates income that has tended to outpace inflation, and fundamentals currently look healthy across property sectors (with the exception of office). Moreover, returns for the asset class have historically been quite strong (+10.2% annualized) following the end of an interest rate hiking cycle, which we are likely approaching soon.

Nontraditional income may be attractive solution investors comfortable with reduced daily liquidity and seeking less correlation to broad macro-economic factors.

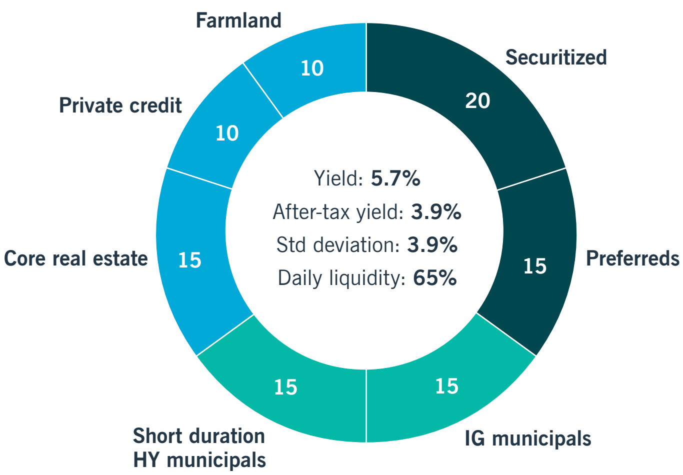
Lastly, these three private market asset classes have experienced negative downside capture over the past 15 years. This means their returns have often been positive when equity returns were negative.

As for **public fixed income markets**, we believe a blend of taxable and non-taxable assets allows investors to benefit from opportunities in both categories.

- On the taxable side, **securitized assets** and **preferreds** offer nontraditional income with yields exceeding those of investment grade bonds. Opportunities within securitized assets include **mortgage-backed** and **agency credit risk transfer** securities (which are floating rate).
- In terms of non-taxable investments, **AAA rated municipal bonds** currently pay taxable-equivalent yields that are higher than Treasury yields across all maturities. And with support from strong underlying fundamentals, **high yield municipals** also merit an allocation in this income-focused portfolio.

FIGURE 2: A BALANCE OF PUBLIC AND PRIVATE ASSETS CAN PROVIDE NONTRADITIONAL INCOME AND LOWER VOLATILITY

Nontraditional income sample portfolio (%)



Data sources: Nuveen Portfolio Strategy Group, Bloomberg, L.P., as of 30 Jun 2023. **Performance data shown represents past performance and does not predict or guarantee future results.** Nuveen has developed these as representative example portfolios, and there is no guarantee that actual allocations will achieve the expected results. **Yield: fixed income**: yield-to-worst; **equities**: dividend yield; **private credit**: 3-year takeout yield; **real estate**: average cap rate of the Green Street Core Property Index; **farmland**: NCREIF Farmland Index compound income return over past four quarters. **Portfolio risk**: defined by Nuveen and based on a balance of standard deviation and liquidity. **Representative indexes: core real estate**: NCREIF Fund Index Open End Diversified Core (NFI-ODCE) Index; **farmland**: NCREIF Farmland Index; **investment grade corporates**: Bloomberg U.S. Corporate Bond Index; **investment grade municipals**: Bloomberg Municipal Bond Index; **high yield corporates**: Bloomberg U.S. Corporate High Yield Index; **high yield municipals**: Bloomberg High Yield Municipal Bond Index; **preferreds**: S&P U.S. Preferred Stock Index; **private credit/direct lending**: Cliffwater Direct Lending Index; **securitized**: Bloomberg U.S. Securitized: MBS/ABS/CMBS and Covered Index; **senior loans**: Morningstar LSTA U.S. Leveraged Loan Index; **short duration high yield municipals**: Bloomberg Municipal High Yield Short Duration Index. Diversification does not insure against loss in a declining market. **It is not possible to invest directly in an index**. See last page for important disclosures regarding asset class related risks and definitions for representative indexes.

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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