

## CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

# Privately protect against economic erosion

## Bottom line up top

**A November to remember.** The market menagerie was in rare form last month: Bears went into hibernation as market volatility cooled along with inflation, while bulls charged ahead as monetary policy doves drove the hawks away. The S&P 500 Index (+9.1% total return in November) scored one of its best months since 2003, and the Bloomberg U.S. Aggregate Bond Index (+4.5%) realized its highest monthly gain since 1985. Global benchmarks such as the MSCI All Country World Index (+9.2%) and the Bloomberg Global Aggregate Bond Index (+5.0%) also joined the jubilee. Despite these gains, we urge investors to remain mindful of underlying macroeconomic risks.

### **Are cracks in consumer credit a canary in the coal mine?**

The remarkable resilience of U.S. consumers, bolstered by strong wage growth and a stubbornly tight labor market, has driven 2023's economic successes. And while the holiday shopping season kicked off with record amounts spent on Black Friday and Cyber Monday, much of that consumption was paid for on credit. Week-over-week use of the "buy now, pay later" option increased by 72% during that shopping spree, a warning sign that household liquidity could be starting to run dry. And while heavy credit card balances may have been less concerning in the previous decade's lower rate environment, interest assessed on revolving debt has nearly doubled since the middle of the 2010s (Figure 1). Additionally, if consumer delinquencies continue to climb, as they have in recent months, excessive debt could end up being not only the canary in the coal mine, but also a primary reason investors might eventually find



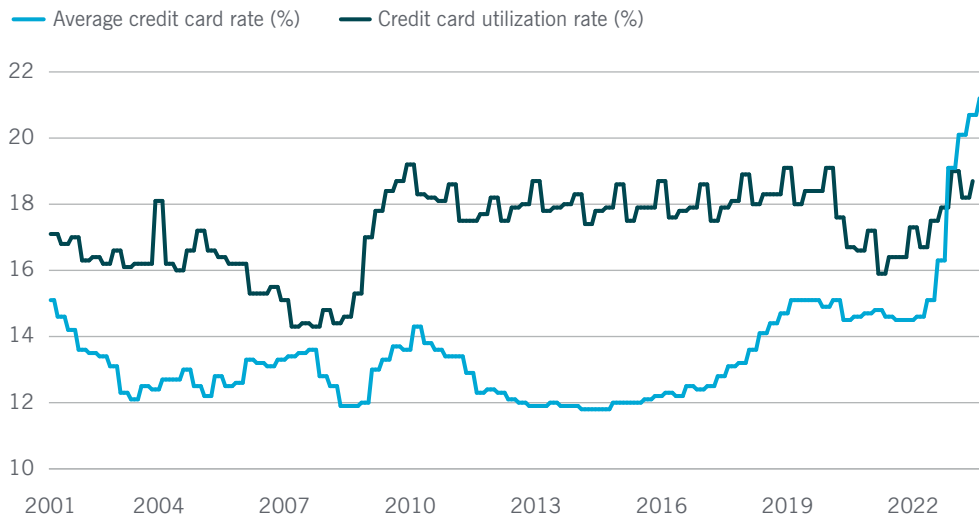
**Saira Malik, CFA**  
*Chief Investment Officer*

*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.

lumps of coal in their portfolio stockings. Fortunately, we have investment ideas to counter the potential impacts of economic deceleration, or even recession, that could occur in such a scenario.

**FIGURE 1: RISING CREDIT CARD RATES COULD SIGNAL TROUBLE AHEAD FOR THE CONSUMER SECTOR**



Data source: Bloomberg L.P., Average credit card rate is from Jun 2001 to Aug 2023 and represents the Federal Reserve Consumer Credit Commercial Bank Credit Card Rate. Credit card utilization rate is from Jun 2001 to June 2023 and represents total industry credit card loans outstanding as a percentage of total industry credit card lines available.

## Portfolio considerations

One investment area to consider is private credit, where deal flow has picked up materially over the last couple of months. Private equity firms that were sitting on the sidelines have jumped back into action as inflation continues to decline and the U.S. Federal Reserve signals that additional rate hikes are likely not needed. As for private equity middle-market direct lending, our analysis shows deal volume reached \$19.6 billion in the third quarter, up 12% from the second quarter. We believe deal activity will remain robust. Furthermore, private credit fundamentals remain sound. The Proskauer Private Credit Default Index (a gauge of the health of the traditional middle market) showed the default rate declining to 1.4% in the third quarter, a second consecutive quarterly decrease.

Since the Fed initiated its aggressive rate-hiking cycle in March 2022, private credit has benefited from the floating rate nature of the asset class. Our analysis shows middle market loans are currently yielding approximately 12%, and even if a couple of rate cuts materialize in the second half of next year, we expect that yield will remain in double digits. We also think private credit should be able to withstand an economic slowdown. Per our analysis of Moody's data, since 1995, middle market loans have had a default rate of 4.0%, with a recovery rate of 77.5%, leading to an annual loss of 0.9%. That's

***While economic growth has remained surprisingly strong in 2023, we see reasons to expect a slowdown next year.***

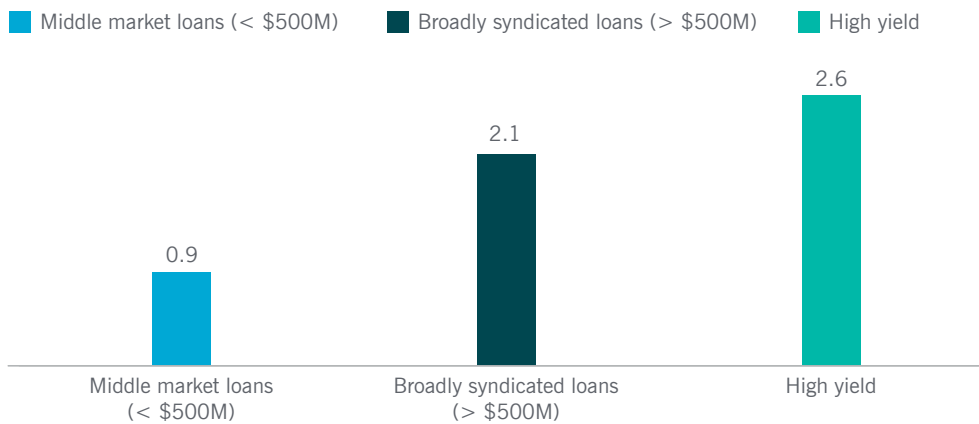
less than half the annual loss of broadly syndicated loans and high yield bonds (Figure 2). Even if defaults slowly creep up, we think they'll remain well below their long-term average, providing a tailwind for private credit.

As for specific private credit sectors, the challenges facing consumers next year make us wary of cyclical, consumer-oriented areas such as retail and restaurants. Instead, we favor opportunities in the business services sector, which is less exposed to discretionary spending. For example, consulting firms that provide design support for infrastructure projects make attractive borrowers. Municipalities hire these companies to design and engineer facilities or systems that provide essential services, for which demand tends to remain steady — even in an economic downturn.

***Private credit markets (particularly middle market direct lending) should be an area well-positioned to withstand an economic downturn.***

## FIGURE 2: MIDDLE MARKET LOANS HAVE ENJOYED STRONG RESILIENCY

Average annual loss rates (%)



Data source: Moody's and PitchBook LCD. 1995 through 3Q 2022 (data reported on a one-year lag). Performance data shown represents past performance and does not predict or guarantee future results. Loss rate categories and data are based on the Moody's Default & Recovery Database: Middle market loans include facility sizes of less than \$500 million; Broadly syndicated loans include facility sizes of \$500 million and more; High yield includes all U.S. below-investment-grade bonds in the Moody's database.

## About Nuveen's Global Investment Committee

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*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

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**For more information, please visit [nuveen.com](http://nuveen.com).**

### Endnotes

#### Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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