

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Time for stocking up on defensive positions

Bottom line up top

Equity markets ho-ho-hold on to Santa rally. Global equities extended their weekly winning streak to six, boosting the year-to-date return of the MSCI All Country World Index to an impressive +15% and lifting the S&P 500 Index into bull market territory (+20%) for 2023.

The recent injection of joy to the world of investing has been driven by inflation and macroeconomic data supporting an end to the U.S. Federal Reserve's rate hike cycle and fueling market anticipation for as many as five rate cuts in 2024, beginning as early as March. But we remain focused on the downside implications for economic growth if that many rate cuts, that soon, were to materialize. With corporate earnings growth muted or modestly negative in 2023, equity market valuations appear frothy, as multiple was expansion driven almost entirely by price appreciation. We don't think the Fed will cut rates any time soon, but if policy actions were to meet the bulls' optimistic expectations, the probability of recession — and heightened market volatility — would almost certainly rise.

Labor and the state of the consumer. Last week's slate of U.S. employment data for November included a number of upside surprises, demonstrating the labor market's continued ability to defy expectations. Nonfarm payrolls (+199K) beat consensus forecasts, while monthly wage growth (+0.4%) re-accelerated and the unemployment rate dropped to 3.7%. In addition, weekly first-time unemployment claims were essentially flat, and continuing claims fell. One potential fly in the ointment: the jump in payrolls was at odds with the latest JOLTS report on job openings (Figure 1), which declined to their lowest level



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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.

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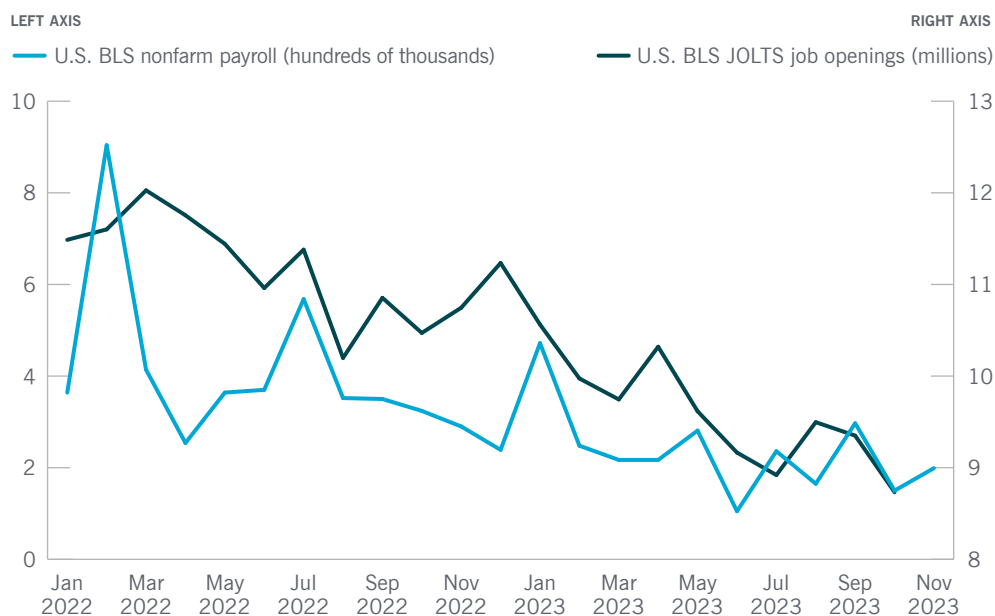
Equity market valuations appear frothy, with multiple expansion driven almost entirely by price appreciation.

since March 2021. On balance, however, the week's labor market indicators represented good news for consumers, whose resilience and willingness to spend drove most of the staggering 5.2% growth in U.S. GDP during the third quarter.

Despite the encouraging data, some cracks in the consumer foundation have become more visible. Their increasing use of credit, higher cost of debt and rising delinquencies warrant caution. So does November's consumer confidence survey data from The Conference Board, which for the third month in a row showed the short-term expectations index below 80 — a level associated with recessions occurring in the following year. Indeed, about two-thirds of consumers surveyed last month said a recession is somewhat or very likely in the next 12 months. We agree that economic growth will decelerate in 2024, although not by enough in the first half of the year to spur rate cuts. Inflation, while continuing to trend down, is unlikely to hit the Fed's 2% target quickly. In the meantime, the economy has absorbed higher interest rates without contracting, leaving us firmly in the higher-for-longer camp.

FIGURE 1: JOLTS DATA DOWN BUT PAYROLLS ARE UP

Nonfarm payrolls (seasonally adjusted) and job openings



Data sources: Factset, U.S. Bureau of Labor Statistics. 07 Dec 2023.

Portfolio considerations

Three kings who traverse afar, three ships that come sailing in and three spirits on a mission to redeem the miserly Scrooge — 'tis the season of threes. With that in mind, we offer our perspective on three asset class opportunities for investors working on their portfolio shopping lists.

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We expect the Fed's current interest rate status quo to last until the second half of next year.

Dividend growth stocks. U.S. dividend growers are supported by positive fundamentals, sustainable growth potential and ample free cash flow, all of which makes them well positioned to enter 2024 on a cautiously optimistic note. Their capital flexibility allows them to return more cash to shareholders via increasing dividend payments. Additionally, these companies have historically proven resilient amid heightened volatility following Fed rate hiking cycles, when the economy is still adjusting to the lagging effects of the hikes, causing activity to slow, and changes in monetary policy remain on hold. We expect the Fed's current interest rate status quo to last until the second half of next year.

Publicly listed infrastructure. Surprisingly strong economic growth, led by stalwart consumers, contributed to listed infrastructure's underperformance relative to broad global equity markets for much of 2023. However, we expect the asset class to find favor again in 2024. A macro environment in which volatility may spike on rising geopolitical risks and rate-driven slowing growth should help boost global infrastructure's appeal, as investors seek defensive holdings. Demand for the services and operations of infrastructure companies tends to hold up relatively well in an economic downturn, creating a potential buffer. What's more, infrastructure is generally well insulated from higher debt costs (i.e., interest rates) and persistent inflation, thanks to inflation escalators built into contracts.

FIGURE 2: PROFITABILITY FACTORS HAVE WORKED FOR TOP-PERFORMING MATERIALS STOCKS IN 2023

Relative year-to-date return (%)



Data source: Bloomberg L.P., 05 Dec 2023. Performance data shown represents past performance and does not predict or guarantee future results. Reference universe is the Russell 1000 Index, materials sector. 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.

The materials sector. The U.S. materials sector has lagged year-to-date, but as with infrastructure, we believe it's poised for better performance next year. What has worked for materials in 2023 are profitability factors. Figure 2 shows the relative year-to-date returns of the top 20% of materials stocks

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versus the bottom 20% for three profitability factors. We expect overall sector performance to follow profit margin expansion in 2024, as it has done this year.

Lastly, inflation that continues to ease from elevated levels could be a tailwind for profit margins in materials. The sector has tended to outperform the broader equity market once Purchasing Managers Indexes (PMIs) bottom. The U.S. manufacturing PMI has been in contraction territory all year and may be nearing its trough in the near term.

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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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Endnotes

Sources

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

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