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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

When market and election cycles meet

Bottom line up top

A lesson in history. U.S. presidential elections have occurred 23 times since 1932, bringing with them increased market uncertainty as investors position portfolios based on expectations for the next four years of shifting political winds. In fact, during that timeframe, the Chicago Board Options Exchange Volatility Index (the VIX, a measure of expected S&P 500 Index volatility), has risen nearly 10%, on average, in election years versus non-election years. But even amid this heightened volatility, U.S. equities have historically performed well in election years. What's more, equity market returns during the 12-month periods immediately preceding and following a presidential election cycle have been positive more often than not (Figure 1).

This election year, a defensive portfolio should be a strong candidate. We're cautious about 2024 given market expectations for an aggressive Fed rate-cutting cycle beginning as soon as March. We believe the pace and scope of this anticipated easing may be too dovish. In our view, the Fed is more likely to keep its finger on the "pause" button until the second half of the year — a scenario that could fuel higher equity market volatility beyond potential political uncertainty as November approaches. Additionally, we're concerned about U.S. consumers, who are burdened by record levels of credit card debt at elevated interest rates.

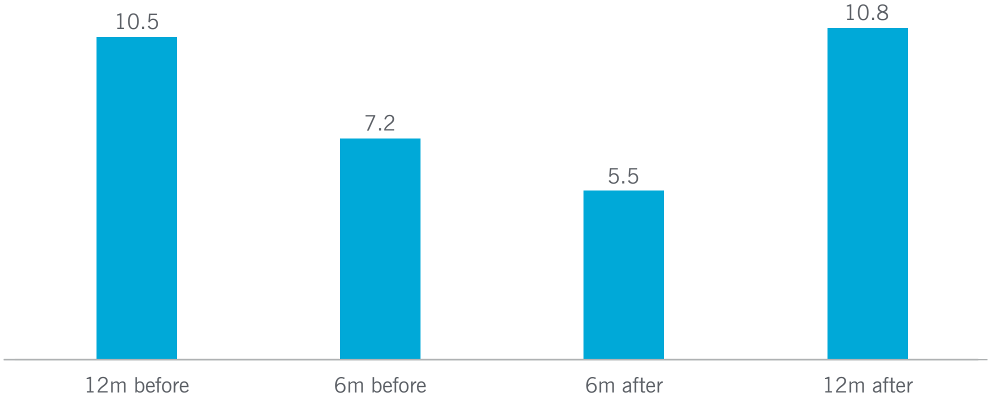
Saira Malik, CFA
Chief Investment Officer

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: U.S. ELECTION YEAR STOCK RETURNS HAVE HISTORICALLY BEEN STRONG

Average 6- and 12-month returns (%)



Data sources: Bloomberg L.P., U.S. presidential election year returns from 1928 to 2020. **Performance data shown represents past performance and does not predict or guarantee future results.** Data reflects the performance of the S&P 500 Index.

Uncertainty surrounding both politics and interest rates could spark higher market volatility in 2024.

Portfolio considerations

Our concern about potential risks in the year ahead informs our current equity market views: We suggest focusing less on cyclical exposures in favor of more defensive, less economically sensitive areas. These include market areas such as U.S. dividend growers and global infrastructure.

- **Dividend growers** are supported by positive fundamentals, sustainable growth potential and ample free cash flow. They have also historically demonstrated resilience during prior periods of heightened volatility and following Fed rate-hiking cycles.
- **Global infrastructure** companies typically benefit from inelastic demand for the basic necessary services they provide.

Notably, both dividend growth and global infrastructure stocks have historically weathered down markets relatively well. We're especially mindful of a potential drawdown in the wake of the remarkably strong equity rally in the final two months of 2023.

Regarding fixed income, Nuveen produces a monthly yield spread monitor that evaluates sector spreads as a valuation tool; an abbreviated version is shown as Figure 2.

- Currently, **preferred securities** and **securitized assets** — sources of nontraditional income with yields exceeding those of investment grade bonds — are offering spreads wider than their long-term averages. Preferreds are supported by strong underlying credit metrics for U.S. banks (evidenced by the Fed's 2023 "stress test" results) and by generally better-than-expected bank earnings over the past few quarters. Within securitized assets, we're particularly favorable toward non-agency mortgage-backed securities, where we see low risks of prepayment given the likely higher-for-longer rates environment.

- By comparison, **investment grade corporates** have tight spreads — but we think this is justified given the attractiveness of these bonds in an environment where (1) the economy is projected to slow and (2) longer-duration exposure should benefit when rate cuts eventually arrive. The corporate curve is also offering higher yields on longer-dated versus intermediate maturities. Lastly, we anticipate investment grade corporate default rates will remain low.

We prefer more defensive areas of the equity market, and a focus on select credit sectors within fixed income.

FIGURE 2: PREFERRED SECURITIES, SECURITIZED ASSETS AND INVESTMENT GRADE BONDS APPEAR TO OFFER VALUE

Current and historical fixed income spread levels

	IG corporates	Preferreds	Securitized
Yield to worst	5.21	6.92	4.85
Spread	1.09	2.17	0.51
Change since YE 2022	-0.33	-0.63	-0.05
3Y avg spread	1.24	2.19	0.45
5Y avg spread	1.30	2.10	0.48
10Y avg spread	1.32	1.95	0.39
3Y z-score	-0.60	-0.06	0.37
5Y z-score	-0.68	0.11	0.22
10Y z-score	-0.80	0.33	0.82
Duration	8.35	4.72	5.82

Spreads tighter than historical average — Spreads wider than historical average

Data source: Bloomberg, as of 08 Jan 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Representative indexes: **Investment grade:** Bloomberg Barclays Liquid Investment Grade Corp Total Return Unhedged USD Index; **Preferreds:** ICE BofA US All Capital Securities Index; **Securitized:** MBS/ABS/CMBS and Covered TR Index Value Unhedged USD Index. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting.. **Spreads** reflect option-adjusted spreads relative to U.S. Treasuries. **Z-scores** are a calculation of the number of standard deviations between the current spread and the average historical spread.

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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