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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

A valuable earnings season kicks off

Bottom line up top

Can earnings manufacture more upside for U.S. equities? In the wake of a strong global equity market rally in the final two months of 2023, the fourth quarter earnings season for S&P 500 Index companies may be telling as to whether the next move for U.S. stocks is a leg up or a leg down. Although the reporting season is just beginning, an earnings contraction is possible after the prior quarter's upbeat results (the first period of positive growth since the third quarter of 2022). According to FactSet as of 19 Jan, blended earnings growth (a combination of reported and estimated earnings) for the fourth quarter is expected to be modestly negative (-1.7%). That said, it's too early to draw any sweeping conclusions with just 10% of index companies reporting — a small sample size representing a narrow band of sectors.

On a full-year basis, FactSet's 2024 consensus earnings growth estimates seem ambitious at +12.2% amid what we see as several downside risks, including elevated labor costs, diminished pricing power due to disinflation, increasing cracks in consumer resilience and a prolonged period of higher interest rates. And with U.S. economic activity expected to decelerate, cost cutting may be the primary tool companies use to protect or expand margins in 2024.

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.

Among the economic signals flashing yellow (or red) are the increasing use and cost of credit accompanied by rising default rates. In addition, though it hasn't made big headlines, U.S. manufacturing activity is stuck in one of its worst recessions in recent history (Figure 1):

- The Institute For Supply Management (ISM) manufacturing gauge has lingered in contractionary territory (readings below 50) since November 2022.
- The New York Federal Reserve's Empire State Manufacturing Survey (ESMS) Index has been negative in 12 of the past 18 months. Its precipitous month-over-month drop in December was the second-largest decline in ESMS history.

Joining the Empire State in the doldrums is the Philadelphia Fed Index, a measure of manufacturing conditions in the Third Federal Reserve District. In January, the "Philly Fed" contracted for the fifth consecutive month, and 18th of the past 20. While these forecasts for both corporate earnings and the economy's manufacturing sector may be partly or mostly cloudy, they offer clarity in their implications for investor portfolios, especially within equity allocations.

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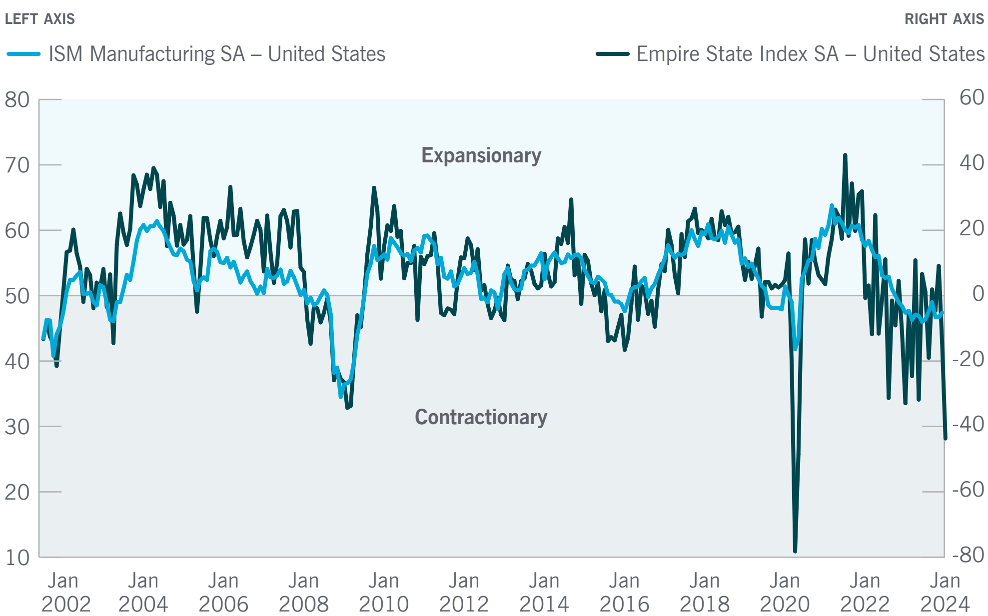
FIGURE 1: MANUFACTURING ACTIVITY SHOWS WEAKNESS

Index levels (seasonally adjusted)



Data sources: New York Federal Reserve, Institute for Supply Management, FactSet, 17 Jan 2024.

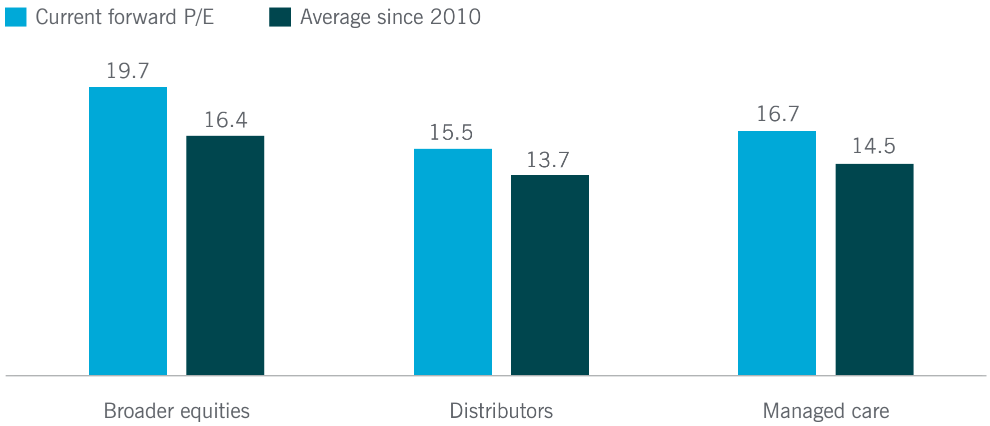
Portfolio considerations

Following last quarter's strong equity market rally, most sectors are now trading at a valuation premium relative to history. The S&P 500 Index ended the quarter with a forward price-to-earnings (P/E) ratio of 19.7x — a 20% premium compared to its average since 2010 (Figure 2). The kickoff of earnings season puts these elevated valuations under the microscope.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

FIGURE 2: HEALTH CARE VALUATIONS LOOK ATTRACTIVE RELATIVE TO BROADER EQUITIES

Current forward P/E versus average since 2010



Data sources: Nuveen, Bloomberg L.P., 31 Dec 2009 to 29 Dec 2023 (monthly data). **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: broader equities:** S&P 500 Total Return Index; **distributors:** S&P 500 Health Care Distributors Sub Industry GICS level 4 index; **managed care:** S&P 500 Managed Health Care Sub Industry GICS level 4 index.

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Among sectors, health care has defensive attributes that we find attractive in the current economic backdrop. But fundamental stock selection is key: If 2024 plays out like most election years, we expect heightened volatility, and within health care, pharmaceuticals are particularly more vulnerable to negative returns. We therefore favor managed care and health care distributors.

- Managed care has seen a sharp rise in investment income as a percentage of earnings per share (EPS), as the large reserve balances these companies tend to maintain grew appreciably thanks to rising interest rates. We think that the market's expectations for U.S. Federal Reserve rate cuts this year are overly optimistic, and that a prolonged pause is more likely, thus managed care looks well-positioned for this environment.
- Distributors are a critical part of the health care supply chain, serving as a conduit between manufacturers of medical supplies and the health care providers who use them. Less tied to interest rates than managed care, distributors are defensive and typically fare well when investors rotate into defensive positioning. Additionally, unlike pharmaceuticals, distributors are less sensitive to patent "cliffs" and specific headline risks that may trigger idiosyncratic volatility. Instead, they benefit from generic drug launches.

Information technology has continued to garner headlines and investor attention. While it enjoyed a banner year in 2023, results were dominated by outsized gains from a narrow group of mega cap companies. We generally prefer tech areas that are less cyclical and less consumer-centric, such as software. Software companies often have resilient business models and inelastic demand for their products and services, with cash flows driven by enterprise clients — a more consistent source of recurring revenue than consumers. Lastly, software companies tend to be more adaptable to changes in the economic environment, with the ability to cut costs without curtailing their business.

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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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. The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **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. 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. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

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