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Weekly Equities Commentary

1 March 2021

Inflation fears weaken investor sentiment

The S&P 500 fell by 2.5% for the week, with growth stocks outperforming value for the first time in nine trading sessions. The rotation into value may have been temporarily stalled, due to potentially oversold conditions combined with decreasing yields. The consumer discretionary and technology sectors fell by nearly 5% and 4%, respectively, while utilities also fell by 5%. Energy was the lone weekly gainer, adding 4.3%, while financials and industrials lost the least.

HIGHLIGHTS

- **Rising bond yields continued to dominate headlines, with the 10-year Treasury yield surpassing 1.6% for the first time in a year before closing the week at 1.44%.**
- **February's Consumer Confidence reading exceeded expectations (91.3), while sentiment surrounding job markets also improved.**
- **President Biden issued an executive order calling for a review of supply chains related to semiconductors, EV batteries and related rare-earth minerals to bolster U.S. procurement and production.**

Saira Malik, CFA
CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen as chair of the Equities Investment Council (EIC) and a member of Nuveen's Global Investment Committee (GIC). She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies, as well as portfolio management responsibilities for global equity strategies.

Weekly overview

- *While volatility declined through most of February, the rapid run-up in yields caused the VIX to spike on Thursday, coinciding with a corresponding broad decline for equities. The tech-heavy Nasdaq took a particularly heavy hit, falling 3.5% on the day.*
- *The House of Representatives passed the $1.9 trillion coronavirus relief package on Friday. While the total dollar amount may ultimately be smaller, the bill should become law before unemployment benefits expire in mid-March. Eyes are now turning toward a possible infrastructure package that could be potentially funded through tax increases.*
- *Fed Chair Powell reinforced his commitment to a dovish approach to fiscal policy during his testimony last week. Investor sentiment and expectations for a rapid economic recovery appear to be behind the recent yield spikes, rather than an overheating economy. Yields remain near historic lows, giving the Fed some policy flexibility.*

Market drivers & risks

- **Coronavirus risks remain, but the news is trending positive.** While variants pose a potentially significant risk, coronavirus metrics have improved. New cases, hospitalizations and deaths are down significantly as vaccination rates climb. The number of people with at least one dose is approaching 50 million, as 20 million doses of Johnson & Johnson's vaccine are shipping following FDA approval. These trends are substantial reasons to be optimistic for a global recovery in 2021.
- **Inflation risks are impacting sentiment.** We have been anticipating a sentiment-driven equity pullback fueled by fears of inflation, as last week's rapidly rising yields startled investors into believing a taper-tantrum could be imminent.
  - The economy appears to be improving, rather than overheating, as reflected by rising commodity prices, cyclical outperformance, real inflation data, 2021 GDP growth expectations and the Fed's commitment to accommodative policy until conditions normalize. Volatility spikes driven by inflation risks may create opportunities in quality companies poised to benefit from economic reopening, as well as in long-term growth companies whose valuations have fallen.
- **To that end, stocks at the epicenter of the coronavirus continue to look attractive on a relative basis**, as high-growth companies tend to lag in rising rate environments.
  - As fundamentals and earnings continue to drive markets, we expect active managers may outperform, given their ability to generate alpha by reducing downside exposure and concentration risk through flexibility; remember, roughly half of the S&P 500 is currently tied to technology, consumer discretionary, and communication services – deemed to be the coronavirus "winners."

> ***"We have been anticipating a sentiment-driven pullback fueled by fears of inflation, as rapidly rising yields startled investors last week."***

Risks to our outlook

Disorderly yield growth and inflation risks remain our biggest near-term concerns. Any indication of an impending tapering of quantitative easing may cause investors to overreact, resulting in a possible pullback (as we witnessed last week).

Coronavirus variants remain at the forefront of possible risks, given their propensity to spread more quickly, the capacity to be more deadly and the potential to disrupt economic reopenings. Additionally, stimulus-driven volatility is likely to persist until a package has been passed.

We are also monitoring valuations. Bitcoin's recent surge indicates investor exuberance, with price momentum reaching dot-com, bubble-era levels. While a short-lived, sentiment-driven correction is possible, economic and earnings growth should continue to underpin investor confidence.

Best ideas

We continue to believe U.S. small caps offer value and remain favorable, as they are poised to benefit from a re-opened economy and stimulus. Overall, our key investment theme centers on looking for quality across geographies, sectors and industries. Additionally, technology and consumer-related industries within emerging markets appear attractive.

In focus

Continued recovery in financials

The financial sector was one of the biggest laggards of 2020, but is now the second-best performing sector in the S&P 500 this year, behind energy. The combination of vaccinations, stimulus and better-than-expected consumer-credit quality and savings have helped the sector return to more-normalized valuations, especially within the banking and consumer-focused credit card industries. While certain earnings drivers may remain weak (e.g., loan growth), we expect financials to be a relative outperformer, given improving fundamentals supported by economic growth, rising rates and improving capital return, especially in the second half of 2021.

Following a decade of relative underperformance outside the U.S., we believe that the sector is benefiting from similar top-down tailwinds. We have observed a broad swath of European banks making positive revisions to their fourth quarter 2020 earnings – something we have not experienced in the last five years. Furthermore, the quality of these revisions has been much higher than expected, based on solid balance sheets, fee income strength and lower credit costs.

Investors have already accounted for many of these improvements and tailwinds. However, we believe the rotation away from growth and defensive areas into more value and cyclical names will continue to drive the financial sector in 2021, improving the capital return environment for yield-hungry investors.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers averaging three decades of investing experience. The group brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

For more information or to subscribe, please visit nuveen.com.

Sources

All market data from Bloomberg, Morningstar and FactSet

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