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Weekly Equities Commentary

21 Jun 2021

We expect the reflation rally to resume

Global equities faced increased volatility last week in light of the Federal Reserve's more-hawkish-than-expected policy meeting. The S&P 500 and DJIA retreated 1.9% and 3.4%, respectively, while the tech-heavy Nasdaq lost only 0.3%. Outside the U.S., the MSCI EAFE, EM, and ACWI ex-USA indexes each fell between 1.5% and 2.4%.

HIGHLIGHTS

- **U.S. retail sales growth declined in May (-1.3%), led by building materials and motor vehicles, but still remains positive compared to pre-pandemic trends.**
- **Initial jobless claims rose for the first time in nine weeks, advancing 37,000 to 412,000.**
- **Volatility picked up, with the VIX rising above 20 for the first time since May 21 to end the week at 20.7.**
- **Treasury yields were volatile, rising after last week's Fed meeting before settling back down by the end of the week.**

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

- *The reflation trade came under pressure last week following Wednesday's FOMC meeting and subsequent press conference by Chairman Powell. The Fed's remarks were interpreted as being more hawkish than expected by investors. There were no discernable comments that hinted at a shift in timing regarding rate hikes or tapering, which seemed to inject fear of a loss in reopening momentum into markets (more on this topic later).*
- *Almost all sectors lost ground last week, with performance driven by the counter-cyclical theme. Information technology was the lone winner, adding 0.1%, while consumer discretionary (-0.1%) and communication services (-1.1%) were among the relative outperformers. Energy (-5.2%), financials (-6.2%) and materials (-6.3%) were the worst performers for the week due largely to falling rates and commodity prices.*

Market drivers & risks

- **The Fed creates a stir.** The central bank discussed a timeline for tapering at its policy meeting last week, and also ramped up its projections for 2021 GDP growth (from 6.5% in March to 7% now) and core inflation (2.2% to 3%). The Fed's projections for rate hikes remained intact (late 2022 at the earliest).
  - This is the most hawkish tone from the Fed since the pandemic began. But taken in context, the central bank remains committed to an accommodative posture. The Fed's statements sparked an immediate rotation out of the reflation trade in favor of growth and defensive sectors, but we anticipate cyclical leadership to return as investors return their focus to the realities of long-term accommodative policies. Chair Powell also pointed to the likely transitory nature of recent inflation spikes, which should also help more cyclical areas of the market.
- **Commodity prices cooling off.** The recent inflation jumps fueled by spikes in commodity and input costs appear to be subsiding. Although energy and oil prices remain elevated as travel restrictions are lifted, we saw steep price drops for many commodities last week.
  - Supporting the Fed's call that inflation is somewhat transitory, a confluence of events led to sharp depreciation in corn, gold, lumber, copper and other commodities: easing of port congestion, a strengthening U.S. dollar and China's commitment to begin selling off industrial metal stock prices. Moderating commodity prices should be sustainable as global supply chains improve. This should in turn help those industries concerned with margin compression caused by rising input costs.

"Reopening trends, vaccine rollouts, relative valuations and sector weightings suggest a bump for non-U.S. markets."

Risks to our outlook

The "delta variant" of the COVID-19 virus has become the dominant strain in the U.K., causing a spike in cases and hospitalizations. Should this variant spread and prove to be more resistant to vaccines, we would likely see significant volatility in global equity markets.

Inflation concerns appear to have moderated following May's CPI report and the recent decline in commodity prices, but volatility could spike amid further data showing accelerating wage growth and/or unwieldy price appreciation. Related, we think labor supply constraints may slow the economy's return to normal. With businesses finding it increasingly difficult to fill positions, we are seeing signs of flattening mobility, which could hamper economic and earnings growth.

With rate hikes still likely far in the future, a flattening yield curve could hinder those industries that are more sensitive to interest rate momentum such as financials, which benefited from sharp yield increases in the first half of 2021.

Best ideas

We see opportunity in developed non-U.S. markets. Europe in particular appears relatively inexpensive and should benefit from improved vaccination rates, earnings growth and a more cyclically oriented economy. A strengthening dollar could bolster returns for U.S. small caps in the near term, while industrial companies benefiting from cyclical momentum should be helped by strong economic growth. We are bullish on select industries within emerging markets, such as China's lodging and gaming sectors. These areas stand to benefit from easing travel restrictions as the global vaccinated population grows.

In focus

Prospects for Chinese leisure and lodging

We've devoted several "In Focus" columns this year to our expectation that non-U.S. equities will outperform U.S. markets as global leadership in reflation and recovery from the COVID-19 pandemic shifts to non-U.S. countries and regions. We have recently been focusing on Europe, and this week we turn our attention to China.

As I mentioned during a recent appearance on BloombergTV, China's recovery has been somewhat disjointed, underscored by peaking earnings upgrades and a flattening of leading economic data such as PMIs. But amid this confusion, we see a fertile environment for certain sectors of the Chinese equity market.

We expect roughly 40% of China's population to be vaccinated against COVID-19 by the end of June and 70% by the end of the year. With nearly 20 million doses being administered per day, China will likely experience a boom in travel, leisure and other services spending thanks to strong pent-up demand (similar to what we've seen in the U.S.)

A notable example: China's renowned gaming and lodging industries, such as those in Macau, should continue to feel significant relief as economic and travel restrictions are lifted. Additionally, we believe these lagging-but-recovering industries will continue outperforming China's tech sector, which has undergone a correction amid heightened regulatory risks after delivering exceptional returns in 2020.

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.

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Sources

All market data from Bloomberg, Morningstar and FactSet

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GWP-1691327PR-W0621P