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A wild ride to another record high

Broad-based developed market indices were net gainers last week, while the MSCI Emerging Markets index lost over 2%. Monday's volatility, largely driven by COVID-19 Delta variant headlines, led to one of the worst days for equities so far in 2021, but those losses were quickly reversed and the S&P 500, tech-heavy Nasdaq and DJIA all closed at record highs on Friday.

KEY POINTS

- **High valuations, a flattening yield curve, peaking growth and COVID-19 variants are likely to keep equity markets highly susceptible to volatility.**
- **However, historically low interest rates should help produce solid economic growth through 2021.**
- **Though risks remain, global growth is likely to become more synchronized.**
- **We remain highly selective in the U.S., thanks to elevated multiples, focusing on reasonably priced growth stocks and value sectors that benefit from infrastructure spending, such as industrials.**



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.

Market drivers & risks

- **Fueling the volatility engine.** If “peak/slowing growth” is the engine driving recent equity market volatility, news regarding the COVID-19 Delta variant was a high-octane injection last Monday.
 - It was the worst day for equity markets so far in 2021, but the pullback did not last long. Investors bought the dip and the S&P 500 closed at a record high on Friday. Trading at nearly a 20% premium to their 5-year average P/E, U.S. equities may experience an increasing number of pullbacks in 2021. Stocks should also be supported by accommodative policy, as well as strong corporate and consumer balance sheets. It is important to remain selective, and we favor adding to high-quality companies within defensive sectors like consumer staples to help contend with pockets of volatility.
- **A double-edged sword.** We remain confident that non-U.S. equity markets will eventually outperform as vaccinations allow for sequential global growth. However, vaccinations remain a double-edged sword for markets as the spread of the Delta variant creates a greater degree of volatility in different markets, likely due to lagging vaccinations rates.
 - We have already seen improvement in the distribution of vaccines globally, as well as economic data that indicates a corresponding recovery is occurring abroad. Eurozone PMI hit a 21-year high last week, though this has yet to translate into outperformance for international markets. However, S&P 500 constituents with greater sales exposure outside of the U.S. are experiencing higher levels of earnings growth, providing an optimistic ballast for sequential recovery.
- **Earnings continue to surprise to the upside.** According to FactSet, 88% of the 125 S&P 500 constituents that have reported second quarter earnings have had positive EPS surprises.



The next few months could remain challenging for investors, as continued high volatility and possible near-term market selloffs are likely.”

Additionally, blended earnings growth for the quarter hit 74.2%, nearly 20% higher than consensus forecasts on 30 June.

- 100% of companies within health care, information technology, real estate and utilities have reported earnings above estimates, so far, while the energy sector has the lowest percentage of companies surprising to the upside at 75%. Additionally, companies with negative EPS surprises, in aggregate, are being punished less than they have been over the past five years, with their stocks experiencing a 25% smaller drop, on average, in the wake of their earnings releases. We continue to preach selectivity given these lofty growth rates, and prefer high-quality companies that stand to benefit from future economic drivers such as increasing capital expenditures.

Highlights from last week

- Nine of the eleven GICS sectors ended in positive territory as better-than-expected earnings and a healthy manufacturing PMI helped outweigh concerns. Growth and tech names largely outperformed value and cyclicals, while small caps and large caps performed mostly in line.
- Monday’s losses were all but erased by Wednesday as investors found comfort in the lack of headlines pertaining to an expansion of economic restrictions. Company comments indicating the rise in Delta variant cases has not adversely impacted businesses also provided a ballast for equities.

Risks to our outlook

Global equity markets proved last week just how volatile they can be as a result of spiking COVID-19 data. We expect markets to remain highly susceptible to pullbacks as governments continue to deal with new variants. The reinforcement of economic restrictions will almost certainly lead to a slowdown in global growth.

Economic forecasting remains a challenge, and with decelerating growth taking center stage, we suspect equity markets may react poorly to economic data that miss consensus expectations.

Though rate hikes are still likely far in the future and a flattening yield curve will hinder industries such as financials that are more sensitive to interest rate momentum, we suspect inflationary pressures may return as drivers including wage inflation may create more permanent effects.

Any disruptions in the legislative process toward infrastructure stimulus could spark additional bouts of volatility.

In focus

Staples: Playing defense during volatility

The consumer staples sector has largely lived up to its reputation in the COVID-19 era, providing defensive positioning during the most volatile periods, while lagging peers during the recovery in equity markets. This trend was highlighted again last week.

It should be noted, however, that the sector experienced a dichotomy of winners and losers as a result of economic restrictions: Manufacturers of household and personal care items struggled to keep up with demand as a hoarding mentality struck consumers in 2020, while leadership shifted to food suppliers and beverage producers thanks to consumers returning (with a vengeance) to restaurants and outdoor venues.

In the current environment, consumer staples may offer investors an opportunity for less volatility, not to mention a degree of protection against inflationary pressures thanks to pricing power. The sector also appears attractive from a relative valuation perspective, sitting at a roughly 5% premium to its five-year historical P/E average versus a nearly 20% premium for the broader equity market.

Looking forward, we believe non-U.S. markets provide some of the most attractive investment opportunities within consumer staples, particularly in Europe. In addition to Europe being among the most ESG-conscious, it is also home to some of the most iconic brands within personal care and distilled spirits; industries with strong ties to two of the world's biggest consumer markets: China and the United States.



Best ideas

We see opportunities in developed non-U.S. markets, particularly in Europe, which appears relatively inexpensive and should benefit from improved vaccination rates, solid earnings growth and a more cyclically oriented economy. In the U.S., reflation and expectations for higher yields could bolster returns for small caps, while select industrial companies should benefit from still-improving economic growth. We are also bullish on emerging markets, specifically Brazil and areas such as China's lodging and gaming sectors, which stand to benefit from easing travel restrictions.

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 EIC 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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A word on risk

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