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Weekly Equities Commentary

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Fundamentals intact but recovery concerns increase

Global equity markets were mixed last week. In the U.S., the DJIA and the S&P 500 both fell -0.4%, while the Nasdaq was down more sharply (-1.1%). Despite the loss, July marked the sixth consecutive monthly gain for the index. Outside the U.S., developed equity markets generally rose in U.S. dollar terms, with the exception of China (-4.3%), mainly due to China's regulatory crackdown on its technology sector.

KEY POINTS

- **While the Fed reiterated its ultra-dovish stance, we think investors will refocus attention on inflation as less transitory.**
- **Concerns about China's regulatory crackdown could spill over into global markets, particularly the tech sector.**
- **Equity markets remain vulnerable to increased volatility amid high valuations.**
- **Growth rates may be peaking, but historically low interest rates should help produce solid economic gains through 2021.**

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

- **Q2 earnings beats remain elevated.** This was expected given the combination of outsized estimate cuts early in the pandemic, and now a more resilient macro backdrop supported by stimulus and favorable operating leverage dynamics.
  - — If it holds, the blended earnings growth rate of 83.6%, up from ~74% the previous Friday, would mark the highest year-over-year growth rate since Q4 2020. Nearly 88% of companies reporting so far have posted positive EPS surprises — a record high since FactSet began tracking in 2008. Last week the focus was on big tech, with results tending to mirror the undercurrents of the overall equity market. Apple had a blowout quarter but noted supply constraints as a headwind. Alphabet surged on strength in digital advertising, while Amazon's miss reflected the peak growth theme. We continue to emphasize selectivity given peak earnings growth rates, preferring high-quality companies that stand to benefit from economic drivers such as increasing capital expenditures.
- **Fed notes "progress" but not "substantial further progress."**At last Wednesday's meeting, Chair Jerome Powell confidently reasserted the Fed's intention to stay patient in assessing the timing of tapering.
  - — The Fed acknowledged the improving U.S. economy, but said there hasn't been enough progress to reduce its quantitative easing (QE) asset purchase program. It remains to be seen whether the Fed can convince markets that it will move only when its criteria for rate hikes have been met. That said, investors need to accept that the end of QE is approaching, as the program was originally intended to provide emergency liquidity last year but is now being maintained to keep financial conditions loose.
- **Investor concern rises amid China's tech crackdown.** Chinese technology stocks were slammed with a massive selloff that wiped out hundreds of billions of dollars in market value as investors reacted to Beijing's increasingly aggressive actions.
  - — The situation has played into fears of contagion, driving emerging markets currencies sharply lower. Chinese state media sought to steady the markets on Thursday, asserting the government's commitment to allow companies to access capital markets.

> ***"While markets continue to trade around all-time highs, we must acknowledge that the next few months could see increased volatility and near-term market selloffs."***

Highlights from last week

- Seven of the 11 GICS sectors closed higher, even as investors grappled with concerns that the Delta variant could dampen the recovery, and that the volatility in Chinese technology shares could spread. However, there were no signs of any meaningful shift in the broader positive fundamental narrative. Cyclical sectors such as materials (+2.8%), energy (+1.6%) and financials (+0.8%) performed best. Small caps (+0.8%) beat large caps (-0.4%), while value (+0.6%) outperformed growth (-1.3%).
- U.S. GDP economic growth accelerated to a 6.5% annualized rate in Q2, despite headwinds to production and construction due to increasing materials costs and supply-chain bottlenecks. An 11.8% increase in personal consumption fueled the growth, with a notable contribution from food services and accommodations. Detracting were private inventory investment, residential fixed investment and federal government spending.

Risks to our outlook

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

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

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

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

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, which offers opportunities tied to growth in the global digital economy, including innovative fintech and e-commerce names.

In focus

Health care sector investing in the COVID age

The pandemic created a dynamic environment for innovation and investment in the global health care sector. Governments around the world will prioritize more aggressive investment in local health care systems and infrastructure as we continue to combat COVID-19, learn more about its variants and acknowledge the prospect of new viruses in the future. These increased levels of capital expenditure could provide a long-term tailwind for life science companies.

With headlines focused on COVID-19, progress in emerging biotech has stayed under investors' radar. Several new modalities/platforms, for example, allow scientists to more precisely target diseases through developments in MRNA and smart antibodies. We believe the value these modalities can generate will be recognized over the next several years.

We've seen the fruits of health care innovation in lower numbers of hospitalizations and deaths caused by the Delta variant versus previous dominant strains. Further innovation should yield scalable solutions that improve diagnosis and treatment, while providing compelling investment opportunities.

Health care returns have lagged the broad equity market since the pandemic began, despite generating stronger relative earnings growth. This has led to significant valuation discounts, making the sector a more attractive source of upside potential.

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.

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Sources

All market data from Bloomberg, Morningstar and FactSet.

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