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Growth headwinds drive risk off sentiment

An increase in growth concerns due to the Delta variant, geopolitical tensions in Afghanistan and China's broadening regulatory crackdown caused a sell off in global markets. While U.S. equities emerged relatively unscathed, non-U.S. stocks experienced a notable decline, with the Stoxx 600 down -1.5% for the week and Hong Kong's Hang Sang Index falling -5.8%. Losses for the S&P 500 (-0.6%), DJIA (-1.1%) and Nasdaq (-0.7%) were relatively muted.

KEY POINTS

- **The Fed will hold their annual Jackson Hole Symposium this week, but our expectation is that QE tapering will be announced in September.**
- **Vaccine efficacy remains in focus, but several states affected by the Delta variant show signs of peaking.**
- **PMI Manufacturing and Services preliminary results for August, as well as a view of Q2 GDP, could bolster confidence this week.**
- **Afghanistan will dominate headlines again, while markets will monitor the infrastructure deal and fiscal stimulus to further support the bull market.**



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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

- **July FOMC minutes implications.** The minutes released on Wednesday highlighted several new details, but the outlook did not change.
 - Our view remains that the Fed will announce the QE taper in September and begin in Q1 2022, as there were no significant changes to the growth outlook and core PCE is still expected to moderate into 2022/2023. While economic conditions have improved since December 2020, current labor market challenges led to the conclusion that ‘substantial further progress’ has not yet been achieved. The Fed remains steadfast in providing ‘ample notice’ to market participants in order to avoid a taper tantrum. It also noted that once tapering is completed then rate hikes could start, but are unlikely before 2023. Details about how the taper will be done most likely points to scaling back MBS and Treasuries in proportion to current purchases.
- **Challenging economic data is transitory.** Investors are working through weak data in regards to U.S. growth and the economic recovery.
 - Last week began with disappointing results from the August Empire Manufacturing Index, which although down from a record reading in July, remains consistent with growth. The ongoing decrease in retail sales and goods consumption was scrutinized, yet service consumption continues and the level of core retail sales remains above pre-pandemic trends. Despite some soft results, the economic outlook remains solid. In our commentary last week, we noted disappointing consumer confidence results. If history is any guide, The University of Michigan’s gauge is a contrary indicator, and when the reading is in the bottom quintile the next twelve month return for the S&P 500 averages +11%.
- **Afghanistan’s effects on President Biden’s agenda.** The ongoing situation adds a complication



As the Delta variant wave looks to peak and markets adjust to the Fed’s tapering schedule, we should see improvements to economic data and cyclical sectors reassert themselves.”

for fiscal stimulus, but may also reduce tax increase risks.

- The Taliban’s takeover of Afghanistan may increase geopolitical risks and hurt President Biden politically, which could derail his legislative agenda and Democratic 2022 hopes to retain their House and Senate majorities. The risk is that if President Biden’s approval rating meaningfully decreases, vulnerable Democrats may distance themselves, which could translate into fewer votes for his agenda, including the infrastructure bill and significant stimulus. However, there can be an accompanying market positive as the risk of tax increases may be reduced if there are further complications with fiscal stimulus discussions.

Highlights from last week

- While five of the 11 GICS sectors posted gains for the week, losses in cyclical sectors such as energy (-7.0%), materials (-3.1%) and industrials (-2.3%) confirmed risk off sentiment in U.S. equities. Treasuries held firm, although some yield curve flattening occurred. Given last week’s backdrop, utilities outperformed (+1.9%), followed by health care (+1.8%). Large caps (-0.7%) outperformed small caps (-2.5%), while growth (-0.3%) outperformed value (-1.3%).
- The release of July FOMC minutes brought tapering timing expectations forward, with most participants stating it is appropriate to start reducing some policy accommodation.

Risks to our outlook

Concerns about vaccine efficacy, especially with the spread of the Delta variant, is a risk for the equity market as challenges further impede the path to economic normalization and reopening.

In addition, while the equity market has a tendency to look past geopolitical tensions, the situation in Afghanistan could alter the course for further fiscal stimulus, which continues to be a part of the positive narrative for the stock market.

Outside of the U.S., concerns about slower growth in China are being debated as the rules for the internet sector and new data privacy laws continue as part of the regulatory crackdown.

We reiterate that equity markets are susceptible to pullbacks, such as last week, and may react negatively to economic data that misses consensus expectations.

Despite these challenges, we think that global equity markets will again prove how resilient they are as underlying fundamentals remain strong.

In focus

Oil supply and demand balance may be near

The global energy sector is at a crossroads amid shifting oil supply and demand dynamics and investor uncertainty about the impact of the Delta variant on mobility and fuel use.

In terms of supply, OPEC+ will seek to reverse cutbacks made last spring, ramping up monthly production by 400,000 barrels per day beginning in September and extending through Q3 of next year.

Demand estimates, meanwhile, are subject to negative revisions due to several factors: a drop in the number of flights in China, COVID-19 lockdowns across Asia, slower-than-anticipated global vaccine uptake and fewer U.S. air travel passengers.

The divergent trends of increasing supply and slower demand recovery could bring a quicker rebalance to the oil market, casting doubt on recent forecasts showing crude prices in the \$80-\$100 per barrel range.

Although OPEC+ producers may pause adding barrels in early 2022 given the risk of material oversupply, they are likely still keen to bring their spare capacity back online ahead of any potential resurgence in U.S. shale activity.

The investment implications is for another year of limited U.S. oil supply growth and a focus on balance sheet repair and disciplined capital allocation. We see an emphasis on dividends and share repurchases. Investors eagerly awaiting the next upcycle for energy equities should look to the second half of 2022 as global spare capacity is reduced and demand normalizes.



Best ideas

Discounted valuations present opportunities in developed non-U.S. markets, particularly in Europe, which is experiencing higher COVID-19 vaccine uptake. We expect stronger relative earnings growth to be a catalyst for select stocks in cyclically oriented sectors. We still remain bullish on emerging markets, specifically Brazil, which offers opportunities tied to growth in innovative fintech and e-commerce stocks. In the U.S., continued strong earnings and expectations for higher yields in the next several months should lead to outperformance for cyclical sectors and small caps.

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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