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Equities rebound to start the fourth quarter

Global equity markets contracted last week, with most broad-based indexes losing between 1% and 4%. Though the S&P 500 Index ended the third quarter with a modest gain (+0.6%), it experienced its worst monthly loss since the beginning of the pandemic in September, falling -4.7%. The week closed on a high note, however, as the S&P (+1.2%), DJIA (+1.4%), and the Nasdaq (+0.8%) all rebounded to start October.

KEY POINTS

- **Bond yields to move too far too fast last week, due to fiscal disputes, higher oil prices, supply chain issues and inflation fears. While we forecast a volatile October, many of these issues should be short term.**
- **Cyclicals led for the week, which aligns with our view that economic growth is being delayed.**
- **Companies with pricing power to overcome inflation and expand margins look poised to outperform.**
- **We are finding opportunities in small caps and companies benefiting from the reopening trade, as well as non-U.S. developed markets.**



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

- **Inflation remains “frustrating,” according to Fed Chair Powell**, with price pressures expected to carry into next year.
 - Complications within global supply chains are likely to continue for longer than anticipated, largely due to the surge in the Delta variant. As a result, we may not be out of the inflation woods yet. Though we are confident upward pressures will subside as supply chain woes ease, we expect some degree of permanence to inflation relative to pre-pandemic levels.
- **Economic data remain strong even if growth rates have peaked.** Final second quarter GDP growth has been revised higher, while pending home sales, continuing jobless claims, consumer spending and ISM Manufacturing either improved or surprised to the upside in August.
 - Equity markets grappled with a several headwinds in September, leading to the worst monthly loss for equities since the beginning of the pandemic. However, an accommodative Fed, low inventory levels and strong capital expenditures should help extend the current economic cycle, leaving us mildly bullish looking ahead to 2022.
- **Brent crude hit \$80 per barrel last week for the first time in three years.** With Europe and China experiencing shortages in coal and natural gas, stronger demand for oil as a source of power generation has pushed prices higher heading into winter. Incremental increases in demand can also be seen in India as its economy reopens.
 - Oil prices are likely to rise from here as the northern hemisphere prepares for cold weather,



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

leading to opportunities in the energy sector over the near term. However, prices are likely to level off through 2022 as global oil production increases and demand normalizes.

Highlights from last week

- Ten of the 11 GICS sectors ended in negative territory last week as investors dealt with gridlock in Washington, D.C., and a spike in Treasury yields. Energy was the lone sector to post a gain (+5.8%), with oil prices reaching three-year highs. Relative outperformers included financials (-0.3%) as banks benefited from rising yields, and materials (-0.8%) as commodity prices climbed. Growth lagged value, while small caps outperformed their large cap counterparts.
- Recent data have shown the Delta-driven summer surge in COVID-19 cases may be fading. Southern U.S. states hit hardest by the virus have shown marked improvement in 7-day case count averages, while some northern states have seen moderate increases. Our hope is that higher vaccination rates and the development of new therapeutics (such as the new pill announced by Merck last week) will help prevent a winter surge.

Risks to our outlook

The near-term path of least resistance could be falling market returns due to COVID-19 headwinds, tax and regulatory risks from legislative plans, supply chain issues and corporate earnings warnings.

Risks regarding the U.S. debt ceiling are the highest in a decade. Although a default is, in our view, unlikely, there will be plenty of debate and political brinkmanship on display in the coming weeks.

Markets are beginning to assess the expected impacts of potential increases in the U.S. corporate tax rate and the minimum tax on U.S. companies' foreign income.

The Fed will be under intense scrutiny as it tiptoes toward contractionary policy. With markets so accustomed to quantitative easing and low rates, volatility is likely to rise as investors grow wary of a misstep in timing and/or magnitude.

In focus

Materials and inflation

Inflation continues to be a source of uncertainty for the materials sector, as the ultimate magnitude and duration of recent spikes in costs and prices remain unknown.

Issues on both sides of the supply-and-demand dynamic have created a difficult forecasting environment. Weather, increased emphasis on renewable energy and other green policies and COVID-19-related challenges have prevented global supply chains from satisfying the robust, pent-up demand of consumers whose incomes and balance sheets have been bolstered by historic government stimulus.

Against this backdrop, materials stocks, which saw strong outperformance in the first half of 2021, now lag the broader market by about 5% year-to-date. Within the sector, typical inflation winners and losers are both underperforming.

While uncertain conditions may persist for some time, we see attractive investment opportunities in the materials sector, notably among businesses that can defend and expand their margins, regardless of their position on the supply chain.

These opportunities include downstream purchasers of commodities with pricing power thanks to brand recognition and innovation (such as select paint and packaging producers), as well as upstream suppliers of particular commodities where supply forecasts are currently challenged but whose long-term demand trends are durable (such as certain chemical and metals producers).



Best ideas

In the U.S., reflation and expectations for higher yields could bolster returns for small caps, as well as companies with pricing power and reopening tailwinds. Supportive monetary policy and the prospect of stronger relative earnings growth will be catalysts for select stocks in cyclically oriented sectors to outperform in developed non-U.S. markets, particularly in Europe. Select growth companies well-positioned for reopening, such as front-office software leaders, also look attractive given recent weakness. We continue to advocate a long-term approach that tilts toward cyclicals and value stocks exhibiting strong earnings growth and pricing power.

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](https://www.nuveen.com).

Sources

All market data from Bloomberg, Morningstar and FactSet.

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