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Retail sales, bank earnings keep equities aloft

Global equity markets closed out a second consecutive week of gains. U.S. equities had their best week since July with the DJIA gaining 4.3% and the S&P 500 and the Nasdaq advancing 3.9% and 3.1%, respectively. Outside the U.S., the MSCI EAFE, EM, and ACWI ex USA each added nearly 2% or more for the week.

KEY POINTS

- **Energy prices and ongoing supply chain disruptions underpinned the latest inflation increases, but markets generally shrugged off inflation anxiety.**
- **Big banks provided an auspicious start to earnings season, boosting the financials sector.**
- **While 3Q earnings may be choppy than in the first half of 2021, lower valuations due to last month's volatility could allow equities to grind higher.**
- **Hard economic data (e.g., manufacturing activity and first-time jobless claims) continue to point to delayed, not disappearing, growth.**



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

- **Big bank earnings far exceeded forecasts**, providing a stiff tailwind for the S&P 500.
 - The financials sector as a whole has enjoyed strong outperformance year-to-date, thanks to the reflation trade and expectations for higher interest rates. Though strong credit quality and reserve releases helped drive bank earnings in 3Q, potential headwinds for the sector include loan growth weakness, consumer growth inflection points, net interest income/margins and higher expenses due to inflation.
- **The 10-Year Treasury yield ended the week below 1.6%**, ending an eight-week streak of increases.
 - Interest rate moves have hindered equity investing on many fronts recently, perhaps none more emphatically than the growth factor. That trend reversed last week, as the Russell 1000 Growth Index outperformed its value counterpart. That said, our outlook on style investing is unchanged: In an environment of positive-but-decelerating economic growth, monetary policy that is poised to become contractionary and still-elevated inflation, we remain proponents of selectively barbell high-quality growth with cyclical allocations.
- **Inflation continued to dominate economic headlines**, as both the Producer and Consumer Price Indexes largely confirmed consensus expectations last week.
 - There were marginal surprises to the upside and downside for underlying components of both measures of inflation, but the overriding message was that inflation is here to stay. (Last Tuesday, Atlanta Fed president and FOMC voting member Bostic said inflation should no longer be called “transitory.”) We



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

continue to believe that while inflation will likely retreat from current peaks, it will nonetheless settle above its pre-pandemic levels. Low inventories should eventually be alleviated by a normalization of supply chains, and energy prices are expected to come down after the winter months — two major factors that should not only reduce inflationary heat, but also help extend the current economic cycle through 2022.

Highlights from last week

- Ten of the eleven GICS sectors posted weekly gains thanks to a good start to earnings season, improving COVID trends and a new found optimism for supply chains. The materials sector added 3.6% following rising prices of precious metals. Information technology appreciated 2.6% due to stabilizing interest rates. Communications services was the lone sector with a negative return, mostly on weakness from major telecommunication services. Every other sector gained between 0.8% and 2.0%
- September retail sales far outpaced expectations (+0.7% vs -0.1% m/m). Even though this represents a dip from August’s report, it provided a solid counterpoint to recently weaker consumer sentiment reports. Gains among sporting goods, clothing and food services point to a shift in preference for outdoor activities and experiences, while sales of electronics and appliances declined.

Risks to our outlook

The agreement to delay the U.S. debt ceiling deadline may have calmed markets for now, but volatility might continue to rear its head as the December 3 deadline approaches.

Earnings season could prove to be more of a headwind for equities, as investors begin to digest the true fallout from the Delta variant surge, tax and regulatory risks from legislative plans, supply chain issues and corporate warnings.

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 leery of a misstep in timing and/or magnitude.

In focus

Even-keeled earnings expectations

The largest financial institutions in the U.S. provided ballast for equity market bulls last week following a round of earnings reports that exceeded expectations and spoke to the underlying strength of the U.S. economy. While the messaging from big banks was broadly positive, we are approaching the rest of earnings season with a degree of caution.

Consensus expectations for third quarter earnings growth among S&P 500 companies are between 25% and 30%, slightly higher than for the first quarter of 2021. While earnings growth eventually topped 50% in 1Q, a number of high-profile factors (Delta, supply chains, inflation, the end of stimulus) will likely keep actual 3Q growth rates around the 30% to 35% range. In fact, earnings revisions for the third quarter are the lowest of 2021 so far, with estimates increasing by a modest 3%-4% since the end of June, versus double-digit percentage increases in the previous two quarters. Guidance has been more moderate, too; nearly half of companies reporting so far have issued negative EPS guidance.

Our caution, however, should not be mistaken for bearish sentiment. Trailing and forward-looking valuations have compressed significantly for the S&P 500, having fallen 10% to 20% from first quarter levels. This should allow equities to grind higher even in the face of decelerating earnings growth. The best-positioned companies are those that can build inventories and protect/grow their margins until the headwinds created by inflation and global supply chain disruptions begin to dissipate.



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 could 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.

Sources

All market data from Bloomberg, Morningstar and FactSet.

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A word on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income.

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