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Weekly Equities Commentary

20 December 2021

Fed's hawkish pivot and Omicron rattle equities

Global equities struggled last week as negative Omicron variant headlines and a hawkish shift by the Federal Reserve weighed on sentiment. The S&P 500 fell 1.9%, with the energy, technology and consumer discretionary sectors declining the most. The Nasdaq tumbled nearly 3.0% on the prospect of rising rates, while the DJIA dropped 1.7%. Non-U.S. equity market benchmarks, including the MSCI EAFE (-0.5%), ACWI ex-USA (-0.9%) and EM (-1.8%) indexes, also lost ground.

KEY POINTS

- **Although stocks initially rose following last week's Fed meeting, the reality of tightening monetary policy took a heavy toll by the end the week.**
- **We expect broader market leadership next year as economic growth normalizes, COVID impacts lessen, inflation settles and initial rate hikes fail to derail the economic cycle.**
- **In this week's commentary, we also offer our 2022 forecasts covering economic growth and inflation, corporate earnings, our favorite (and least favorite) sectors and stock market performance.**

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

- **December's Fed meeting delivered a highly anticipated shift in policy projections, but its scope ultimately unnerved investors.**
  - — Equity markets initially rallied in the wake of last week's Fed meeting, as the announced acceleration in the pace of tapering and number of projected rate hikes appeared to align with expectations and provided the Fed with some much-needed credibility in the face of sustained inflation. Once investors fully digested the hawkish tone, however, the yield curve flattened and stock prices fell amid concerns that a rapid increase in rates might cause economic growth to slow. In our view, inflation is likely to settle in 2022, which would suggest the Fed may be overestimating the number of rate hikes needed next year. That would eventually be bullish for equities.
- **The Omicron variant** remains a source of volatility**.**
  - — Equity markets will continue to react poorly to negative Covid headlines, but we don't expect the newest variant to result in an economic cycle-ending event, as each new wave of the virus has had a diminishing effect on economic mobility. That's not to say there won't be pockets of disruption that may cause risk-off trading, but we feel those instances could represent buying opportunities.
- **Focus is shifting from monetary to fiscal policy** as 2022's budget and agenda loom large in D.C.
  - — While the Biden administration managed a victory in securing passage of a "hard" infrastructure package in 2021, its flagship "Build Back Better" agenda remains in limbo until 2022. Expectations are for the BBB to be passed as a part of the budget reconciliation process early next year. However, its impacts appear to already be priced in to equity markets. Any further needle-moving legislation would require significant bipartisan support, which looks unlikely in 2022. Regardless, a legislative logjam beyond the passage of BBB won't substantively alter our outlook for normalized (and above-average) economic growth.

> ***"We expect above-average economic growth, still-high inflation, more volatility and decent equity market returns in 2022."***

Forecasts for 2022:

As part of our last regularly scheduled commentary of 2021, Nuveen's Equity Investment Council offers the following forecasts and market views (as featured in *Barron's* this past weekend) that we believe will shape the year ahead:

- Year-end S&P 2022 target: 5,100
- 2022 S&P 500 earnings per share growth: 9%
- Favorite S&P 500 sector in 2022: energy
- Least favorite sector in 2022: consumer staples
- Year-end 10-year U.S. Treasury yield: 2.0%
- Year-end fed funds rate: 0.5%
- U.S. GDP growth in 2022: 3.9%
- U.S. CPI inflation rate in 2022: 2.75%

Risks to our outlook

Inflation and its impact on central bank policy will continue to exert outsized influence on equity market volatility. The Fed's recent hawkish tone has become more aggressive, causing investors to grow leery of a potential misstep in timing.

Even as markets have seemingly concluded that Omicron does not pose a substantial long-term threat, we still expect volatility to spike with each related headline. The fear of economic restrictions will likely remain an unwelcome overhang for markets.

Legislative uncertainty continues to pose a risk to equity markets despite the one-time debt ceiling resolution. The $1.7 trillion "soft" infrastructure spending package remains in jeopardy.

Geopolitical risks have recently expanded, as tensions between China and the U.S. are brewing again. Further sanctions on Chinese tech firms will likely hamper emerging markets given China's sizable weighting within the broad-based EM indexes. Contentious issues involving Russia/Ukraine and Iran/Israel also present risks, although hopes for successful diplomacy remain intact.

Best ideas

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

In focus

Electromobility: a driving force

We recently highlighted our outlook for battery electric vehicles (BEVs) and their impact on the future of the automotive industry. BEVs remain the heaviest users among autos of electronic components, especially semiconductor chips, reinforcing the importance of the sector.

But there's more to the story than BEVs. The entire motor vehicle industry is being driven forward by the forces of electrification and digitization — collectively known as electromobility — to the point that every car now seems to be evolving into a "smartphone on wheels."

Such technological innovations are showing up in advanced "infotainment," safety and comfort systems in all new vehicles, regardless of make or model. And, like BEVs, these features are highly dependent on semiconductors. This highlights the increasingly critical role semis play in manufacturing new autos — including those capable of fully autonomous driving, one of the industry's hottest and most durable trends.

Expanding electromobility and related developments have created a wealth of potential investment opportunities, but we look beyond the most well-known names in BEVs and semiconductors because they typically carry premium valuations. In terms of auto component suppliers as a group, those who make the safest, most-reliable parts are likely to capture significant market share over the next few years. Among chip manufacturers specifically, we expect to see concentrated leadership from those best-equipped to navigate continued supply chain issues.

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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