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Weekly Equities Commentary

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Stocks start 2022 with losses amid rising rates

Global equities struggled to find their footing in the first week of 2022, as most major indexes lost ground. Within the U.S., more value and cyclically oriented benchmarks fared better. The DJIA fell a modest -0.3%, while the S&P 500 and Nasdaq lost 1.8% and 4.5%, respectively, due in large part to their heavy weightings in technology. Broad-based, non-U.S. benchmarks fell more modestly. The MSCI EAFE (-0.3%), ACWI ex-USA (-0.4%) and EM (-0.5%) indexes lost no more than -0.5%, each.

KEY POINTS

- **2022 began with rising yields, dragging on equity performance due to the impact on growth and technology stocks.**
- **The Fed continues to walk a fine line, but unlike 2021, there is little margin for policy error around wage inflation and interest rates.**
- **We expect Omicron to have relatively limited economic impact, benefiting the reopening trade.**
- **Earnings should drive stock prices in 2022. Moderate earnings growth will equate to positive, yet volatile, equity returns this year.**

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.

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Market drivers & risks

- **Nonfarm payrolls missed expectations (again) in December,** but underlying data and positive revisions to prior months' job numbers tell a healthier employment story.
  - The BLS establishment survey showed an increase of 199,000 jobs in December, far below an expected 400,000. However, October and November totals were revised upward by a combined 141,000. The household survey was more upbeat, tallying up more than 650,000 new jobs for December and the unemployment rate fell to 3.9%, approaching its 3.5% pre-pandemic bottom. Underlying employment metrics, in tandem with other mostly positive economic data, give us confidence in the health of the overall economy. Our focus remains on average hourly earnings, as sustained above-average wage growth is far more likely to disrupt current central bank policy goals.
- **Last week's surge in bond yields** was fueled by hawkish Fed takeaways and expectations of less severe economic impacts from the Omicron variant.
  - The bellwether 10-year U.S. Treasury yield leapt from 1.52% at year-end to close at 1.76% on 7 January. The Fed's accelerated pace of tapering and a more aggressive dot plot, along with the market's relatively sanguine view of the risks Omicron poses to the economy, were the main culprits, keeping expectations intact for three rate hikes in 2022.
- **The market is rotating on its value axis, for now.**
  - Last week's 24-basis-point jump in the 10-year Treasury yield brought with it a corresponding rotation out of growth and technology stocks in favor of value and cyclicals. This could represent a more sustained shift in the factor landscape as prospects improve for rate-sensitive industries (such as banks) and reopening trades (airlines, hotels), but we do not expect last week's degree of outperformance by value and cyclicals to be sustainable. With nearly 40% of Nasdaq constituents down by about 50% from their 52-week highs, oversold conditions should present valuable buying opportunities for select technology and growth names — especially those tied to reopening, such as front-office software providers.

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

Weekly overview

- From a sector perspective, the S&P 500 experienced significant return dispersion last week. Expectations for limited economic impact from Omicron sparked a rally in the price of oil that led to a 10.6% return for energy, while the backup in rates provided a lift for financials, which gained 5.4%. Conversely, higher rates created a stiff headwind for growth-oriented stocks. Real estate (-4.9%) information technology (-4.7%) and communication services (-2.5%) ranked among the worst performing sectors.
- According to Bank of America, global equities garnered nearly $1 trillion ($949 billion) in inflows in 2021, exceeding the cumulative inflows of the previous two decades combined. And equities took in another $26 billion to start the new year, despite last week's growth/tech-driven losses. Even as bond yields continue to climb, equities will likely provide strong total return potential in 2022.

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 hawkish tone has become more aggressive, causing investors to grow wary of a potential misstep in timing or magnitude of contractionary measures.

Even as markets have seemingly concluded that Omicron does not pose a substantial threat, we still expect volatility to spike with each related headline. Although another Covid wave had been anticipated, the fear of economic restrictions will likely remain.

Congress continues to pose a risk despite reaching a one-time resolution on the debt limit. The $1.7 trillion "soft" infrastructure spending package remains in jeopardy, given the Democrats' razor-thin majority and significant objections from within their ranks.

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.

Best ideas

In the U.S., inflation and expectations for higher yields should bolster returns for small caps and financials, as well as for companies with pricing power. Stronger producer discipline and global demand should help extend the cycle for Energy, while select technology companies, such as front-office software leaders, also look attractive. The prospect of stronger relative earnings growth could be a catalyst for select stocks in developed non-U.S. markets, particularly Europe, and select emerging markets (ex-China, given current risks). We continue to advocate a long-term approach that prefers cyclicals and value stocks exhibiting strong earnings growth and pricing power.

In focus

Renewing the case for utilities

The growth outlook for the utilities sector remains bright following a return of nearly 18% in 2021 — its third-highest gain in the past decade. Valuations look attractive, as the sector is currently trading at a discount of approximately 10% to the S&P 500 Index, with a P/E ratio of 19.2x versus 21.4x, based on estimated 2022 earnings per share (EPS).

But the investment potential goes beyond relative valuations. Most utility conglomerates have streamlined their operations, turning into pure-play regulated utilities – which investors typically prefer due to the stability and predictability of earnings that these businesses offer.

Meanwhile, the capital expenditure landscape for utilities is as vibrant as ever, with significant opportunities to invest in energy transmission, system reliability and modernization. We think current capex budgets for utility companies support EPS compound annual growth rates of 5% to 8% over the next five years.

Perhaps the most compelling rationale for the sector is the near-universal effort by its constituent companies to reduce greenhouse gas emissions by steadily retiring high carbon-emitting (e.g., coal-fired) power plants and investing in renewable energy alternatives such as wind and solar. These offer lower construction and operating costs while also helping combat climate change.

As renewable power plants grow in number, so does the regulated asset base for the companies that run them. Shareholders, in turn, should benefit from the substantial and predictable earnings growth fueled by this industry-wide decarbonization.

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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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