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Weekly Equities Commentary

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# Bears overpowering bulls in early 2022

*The rout of global equity markets persisted for the third straight week to start 2022. In the U.S., the DJIA continued its relative outperformance, falling only 4.6%, while the S&P 500 and Nasdaq lost 5.7% and 7.6%, respectively, given their outsized weightings in technology-oriented industries. Outside the U.S., stocks also lost ground, but once again fared better than their U.S. counterparts: The MSCI EAFE, ACWI ex-USA and EM Indexes lost 2.1%, 1.9% and 1.0%, respectively.*

## KEY POINTS

- **Bears are winning the game of tug of war with bulls to start 2022, as uncertainty around Covid, earnings, inflation and bank policy fuels selling.**
- **The impact of these issues continues to support a rotation from growth/technology into value/defensive sectors.**
- **Downward pressure on equities is not necessarily signaling the end of the current bull market, but rather the arrival of a "tantrum 2.0."**
- **Strength in the underlying economy and corporate revenues should help sustain earnings growth.**

**Saira Malik, CFA**
*Chief Investment Officer*

As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she also chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

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## Market drivers & risks

- **The defensive rotation as supply-demand dynamics boost the energy sector.**
  — Energy has carried its dominance of 2021 (+55%) into 2022, gaining 13% year-to-date. A seemingly perfect storm has gathered in the form of a rotation out of growth combined with higher energy prices. With strategic oil reserves unable to satisfy demand, capacity issues have powered the price of crude to multi-year highs. Data suggest that OPEC is not near its planned production level increase (+400k barrels/day). We maintain our bullish stance on the energy sector as reaccelerating demand, consumer strength, production discipline and historical comparisons remain supportive.
- **The individual investor** may be playing a sizable roll in the current tech (over)correction.
  — Fatigue among individual investors set in late last week. After 13 consecutive days of net buying — the longest such stretch since July 2021 — retail assets were in net outflows on Thursday and Friday. The buy the dip mentality that has provided a floor under growth and momentum areas faltered, resulting in an outsized impact on the overall market, given that sector's heavy weightings in mega-cap technology (and adjacent "meme") stocks. Though technical signals have flipped bearish, several growth sectors such as IT and consumer discretionary are moving into oversold territory.
- **Earnings season is off to another strong start,** despite some disappointment among popular names.
  — Current forecasts call for +25% year-over-year earnings growth for the S&P 500 for the fourth consecutive quarter. Markets reacted negatively to higher costs and increased expectations for further expense inflation, but identifying the real impacts of inflation on company earnings should ultimately help provide clarity for investors.

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As the tailwind of monetary support fades in the coming months, we expect outperformance by companies with strong fundamentals and enough pricing power to defend and expand margins amid still-high inflation.

## Weekly overview

- All eleven sectors of the S&P 500 lost ground last week. Dispersion was elevated, with returns for value/defensive companies outpacing that of growth/technology-oriented stocks. Utilities (-0.8%), consumer staples (-1.4%) and real estate (-2.9%) were among the best performing sectors. Bipartisan anti-trust discussion in Congress, rising rates and concern regarding this week's Fed meeting were largely to blame for losses of 7% or more for the IT, communication services and consumer discretionary sectors. It is worth noting that the futures contracts curve of the Volatility Index (VIX) inverted last week – a historical signal that equity markets may be near a bottom.
- Investor malaise took its toll on equity markets once again amid anxiety ahead of this week's Fed meeting. Stocks struggled to find their footing due to fear and speculation about a potential abrupt end to quantitative easing altogether and the possibility of an initial 50-basis-point hike in the Fed's target rate in March (double the previously expected increase of 25 basis points). Investors were unnerved by this uncertainty, having grown accustomed to the central bank providing greater transparency and telegraphing its moves well in advance.


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## Risks to our outlook

While Fed Chair Powell continues to suggest patience with his plan for tapering and rate hikes, the Fed's more-aggressive tone in December has caused investors to grow leery of a potential misstep in timing or the magnitude of contractionary measures.

Even as markets have 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 global equity markets.

U.S. fiscal uncertainty continues to pose a risk. Although the Biden administration's Build Back Better program remains on the table (in some shape or form), the Democrats' thin majority and objections from within their ranks leave little margin for error.

Geopolitical risks have expanded with the further deterioration of relations between Russia and NATO. A conflict appears increasingly likely. Tensions between China and the U.S. also remain just below a boil. Further sanctions on Chinese tech firms would likely hamper emerging markets, given China's sizable weighting in broad-based EM indexes.

## *Best ideas*

*In the U.S., inflation and expectations for higher yields should bolster returns for small caps and financials, and 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 certain 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***

## *Bright backdrop for banks*

One of the biggest laggards of 2020, the financials sector, rallied hard in 2021. Its 35% gain marked its second-best annual return of the post-global financial crisis era. Government stimulus, household savings rates, consumer and commercial credit quality, and a resilient economic backdrop have provided fertile ground for the sector, especially in the banking industry.

Recently, however, a handful of the largest U.S. financial institutions reported fourth-quarter earnings and guidance for 2022 that revealed higher-than-anticipated costs and expectations of further expense inflation, driven primarily by rising wages. While these results have added to the equity market volatility of early 2022, we are fairly constructive on bank fundamentals. Higher interest rates, improving loan growth and abundant excess capital should act as catalysts for further appreciation this year.

Regarding prospects for higher rates, as markets prepare for three or four Fed rate hikes in 2022, we estimate that an increase of 100 basis points across the yield curve could potentially boost earnings per share for the industry by 15%-20%, on average, once these higher rates are fully realized in the earnings stream of the banks.

Meanwhile, though bank valuations (on both a P/E and P/B basis) look a bit stretched versus their own history, they remain attractive compared to the broader market. Banks have historically traded at a median discount of roughly 24% to the S&P 500 as a whole (based on next 12 months' P/E), a margin that currently stands at 34% — still a an intriguing investment opportunity from a relative value perspective.

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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, Chief Investment Officer, 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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