

31 January 2022

# Fed telegraphs lift off, as S&P 500 ends losing streak

*U.S. equity markets showed their first signs of life in 2022, ending their three-week losing streak thanks to a strong Friday rally. For the week, the S&P 500 Index (+0.8%) and DJIA (+1.3%) outperformed the tech-heavy Nasdaq, which finished flat. Non-U.S. markets did not fare as well, however. Rising geopolitical tensions, higher energy costs and U.S. dollar strength created stiff headwinds for the MSCI EAFE (-3.6%), ACWI ex-USA (-3.6%) and EM indexes (-4.3%).*

## KEY POINTS

- **Fed Chair Powell all but confirmed rate hikes in March, but without providing specifics on the pace, or plans for shrinking the Fed's balance sheet.**
- **January's selloff appears to have been an overreaction. We believe economic and earnings growth should sustain the current bull market, despite tighter monetary policy. But earnings will take on greater importance due to valuation levels.**
- **Although heightened volatility will be a theme of 2022, opportunities for outperformance will certainly be available if investors remain selective.**



**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

- **Hawks swoop in as easing turns to tightening**, but bulls should still have room to run.
  - Equity markets interpreted the outcome of last week's Fed meeting as hawkish, with Chair Jerome Powell essentially confirming that rate hikes will begin in March, shortly after quantitative easing (QE) asset purchases are expected to end. Powell also indicated that the Fed will eventually begin to shrink its \$9 trillion balance sheet (quantitative tightening, or QT). Therefore, the Fed has positioned itself to battle inflation that it acknowledges has been running "well above" its 2% target. We don't expect the Fed's currently stated course to be cycle-ending for equity markets. Instead, we foresee moderate equity market appreciation with stocks trading more on earnings than valuations. Selectivity will grow even more imperative, as outperformance should come from companies with pricing power to overcome inflationary pressures.
- **Has individual investor fatigue already begun to fade?**
  - Last week's big swings between gains and losses, paired with Friday's potent rally, may be a sign that individual investors have finally caught their breath. We continue to believe that short-term volatility in technology stocks is creating the opportunity to find high-quality companies that are structurally well-positioned for the long term.
- **Market reaction to positive, but decelerating, earnings growth has been muted.**
  - With one-third of S&P 500 constituent companies reporting fourth-quarter earnings, the index's blended growth rate has surpassed 24% — 3% higher than where estimates stood on December 31. Despite this, price action following earnings releases has been largely



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subdued, as an increasing number of companies have provided lower forward guidance, many citing inflation as a headwind. Rising expenses combined with the looming Fed “lift-off” in March are likely to cast a shadow over this earnings season, though we expect results to remain at or above historic averages.

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## Weekly overview

- Returns were mixed on a sector level for the S&P 500. Dispersion was again a dominant theme, due in large part to energy's remarkable start to the year: the sector gained another 5% last week (+19% year to date). The information technology sector (+2.3%) partially offset January's earlier losses, bolstered by strong mega-cap earnings and encouraging news on supply chains. Financials (+1.4%) were also positive. Sectors losing the most ground were utilities, (-1.4%), consumer discretionary (-1.0%) and materials (-0.9%).
- Economic data continued to provide a solid backdrop. Last week's advance estimate of fourth quarter GDP showed the U.S. economy grew at an annualized rate of 6.9%, a substantial upside surprise. Meanwhile, the Core Personal Consumption Expenditure (PCE) Index (the Fed's preferred inflation barometer) was generally in line with expectations in December, both month-to-month (+0.5%) and year-over-year (+4.9%). Personal income (+0.3%) growth was lower than expected on a monthly basis, while spending (-0.6%) dipped a bit less than anticipated.

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## Risks to our outlook

The Fed's hawkish tone and options for more aggressive measures in March have left investors leery of a potential misstep in the timing or 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.

## *In focus*

# Opportunities emerging in EM equities

Emerging market (EM) equities declined in 2021, with the MSCI EM Index returning -2.5% (including net dividends) in U.S. dollar terms, trailing the developed-market MSCI EAFE Index by double digits. Last year's EM volatility has persisted into 2022, but we believe compelling investment opportunities can be found on a selective basis — thanks to attractive relative valuations, potentially improved political and regulatory landscapes in certain markets, and various idiosyncratic factors.

In China, the largest component of the EM index, contributors to a bullish case include the easing of monetary policy (as the U.S. is tightening) and the possible winding down of issues that derailed Chinese equities in 2021: regulatory intervention, the Evergrande crisis and Beijing's zero-tolerance Covid policy.

Elsewhere in Asia, we favor countries like Taiwan and South Korea, whose strong banking and technology industries stand to benefit from rising rates and ongoing tightness in global semiconductor supply. Meanwhile, oil supply/demand dynamics favor energy producers, likely boosting OPEC+ members.

Finally, EM countries and regions with burgeoning consumer markets (such as India, Indonesia and parts of Latin America) may benefit from what's expected to be diminished impact from Omicron compared to previous Covid variants.



## *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.*

## 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.

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### Sources

All market data from Bloomberg, Morningstar and FactSet.

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