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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Against the current: considering high yield as flows recede

Bottom line up top:

High yield investors ran for the exit. After a brief uptick in flows in August, the last two weeks have seen a renewed flood of money leaving the high yield asset class. Outflows totaled more than $9.6 billion over that period, equal to over 4% of the asset class's total AUM. This marks one of the largest two-week outflows since the Covid-induced panic in March 2020 (Figure 1). In our view, this dynamic does not represent a sea-change for high yield, as a slew of positive tailwinds should keep conditions calmer in the months and quarters ahead.

But they may not be taking in the whole picture. Recent outflows have been partially driven by concerns over rising interest rates. Now that the sharpest rate moves are likely behind us, we see much less scope for further acute outflows. At the same time, we expect the higher level of yields to lure in investors. Overall yields for the high yield index are now above 8.5%, a level that has previously induced investors to move back into the asset class. Even with these attractive yields, the overall quality of the market has improved, with more than half the asset class now rated BB, up from around 40% in 2010 and 35% in 2000. Further, interest coverage is at its highest level since before the Global Financial Crisis, and 75% of the high yield debt outstanding today is not due until after 2025. This should reduce the risk of default-driven losses, which have historically been the main barrier to strong high yield performance.

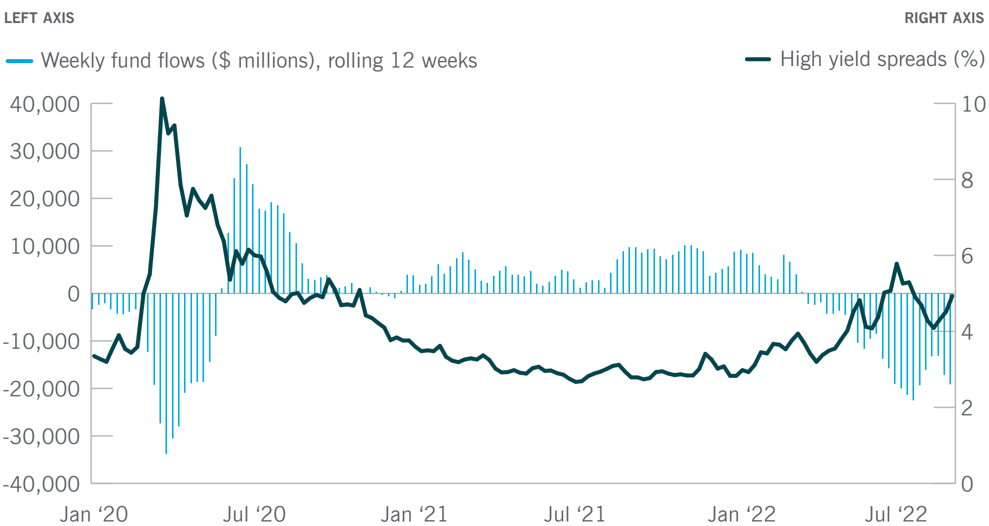
Saira Malik, CFA
Chief Investment Officer

On behalf of Nuveen's Global Investment Committee

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 chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

Investors have been moving rapidly out of high yield. We think that may be a mistake.

FIGURE 1: HIGH YIELD: NEGATIVE FLOWS AND WIDENING SPREADS



Data source: Bloomberg L.P., 3 Jan 2020 to 2 Sep 2022. **Past performance does not predict or guarantee future results. High yield spreads** represent option-adjusted spreads over Treasuries for the Bloomberg U.S. Corporate High Yield Index.

Portfolio considerations:

Steadfast hawkishness challenges the asset allocator in all of us. With the U.S. Federal Reserve's Lael Brainard vowing to fight inflation "as long as it takes," and the European Central Bank's 75-basis-point hike and hawkish guidance, it seems clear central bankers are resolved to combat inflation. But that means more restrictive policy and lower nominal economic growth. It's hard to be bullish on equities with this backdrop.

So how to generate total return while minimizing downside risk? U.S. high yield might be an out-of-consensus idea, and spreads could widen from current levels. But we believe equities are more vulnerable. Shifting from equity into credit could allow investors to access "growth risk," with relatively less downside risk, while also benefiting from attractive yields. This is our "**paid to wait**" mantra. We prefer higher-quality issues across high yield: BB rated paper is still yielding 7%, and has a relatively lower historical default rate, further skewing the positive tradeoff versus equities.

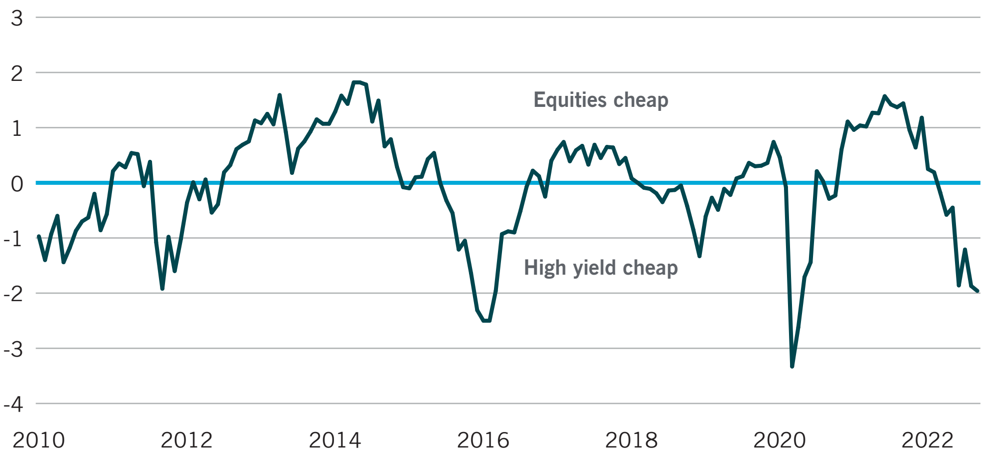
Plus, the entry point looks quite attractive. In Figure 2, we compare the valuation metrics for U.S. high yield and U.S. equities and standardize the difference over time for ease of comparison. Relative to U.S. equities, U.S. high yield is currently priced at one of its more attractive points in recent history. On an absolute basis, the current level of yields has historically proved to be an enviable entry point. Yields hit these levels only six times in the last 20 years, and the subsequent 12-month total return averaged +15.3% in those instances. That's almost double the average return over the same period of around +8%.

Investors seeking to position portfolios for upside potential while limiting downside risk may find tapping credit over equities a compelling way to generate risk-adjusted total return.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

FIGURE 2: A COMPELLING RISK/REWARD PICTURE FOR HIGH YIELD

Risk premium of U.S. equity versus high yield (z-score)



Data source: Bloomberg L.P., 31 Jan 2010 to 31 Aug 2022. **Past performance does not predict or guarantee future results.** Representative indexes: **Equities:** S&P 500 Index; **High yield**: Bloomberg U.S. Corporate High Yield Index. Risk premium measures the relative performance of an investment in excess of U.S. Treasuries. A z-score indicates how many standard deviations an element is from the mean.

Focusing on high yield may be an out-of-consensus idea, but we see compelling opportunities for investors.

About Nuveen's Global Investment Committee

Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.

Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

For more information, please visit nuveen.com.

Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

Important information 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. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes. Investments will be subject to risks generally associated with the ownership of real estate-related assets and foreign investing, including changes in economic conditions, currency values, environmental risks, the cost of and ability to obtain insurance, and risks related to leasing of properties. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria exclude securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt are speculative, subject to substantial risks including the risks associated with limited liquidity, the use of leverage, short sales and concentrated investments and may involve complex tax structures and investment strategies. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not appropriate for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

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