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CIO Weekly Commentary
19 September 2022

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Investing amid a "Fedflation" fixation

Bottom line up top:

Another big Fed hike is expected this week. All eyes are on the U.S. Federal Reserve's meeting this Wednesday, the first since the Fed's August symposium in Jackson Hole, Wyoming. Chair Jerome Powell and his colleagues have been steadfast in their resolve to bring inflation to heel through tighter monetary policy — even if doing so may, in Powell's words, "bring some pain to households and businesses." (Not to mention investors … which he, in fact, did not mention.)

How many basis points are in the offing? Expectations have shifted dramatically in the past few weeks. As of 9 September, markets were pricing in a 90% chance of a 75 bps hike and 10% odds of a 50 bps bump. Now, the prospect of 50 bps is off the table, replaced by the possibility of a 100 bps increase, or one full percentage point. Perhaps more significantly, the hikes expected at future meetings have increased and the terminal policy rate expected to be reached in 2023 has jumped from about 4% to nearly 4.5%.

Inflation remains the hot button. In August, core U.S. CPI inflation (which excludes volatile food and energy prices) spiked month-over-month (+0.6%) and year-over-year (+6.3%), topping forecasts and dashing hopes that a more benign inflation climate might hasten a Fed pivot toward looser monetary policy. And while the producer price index (PPI), which measures wholesale inflation, subsequently came in cooler (-0.1%) for August and year-over-year (slowing to 8.7% from 9.8%) — this was not enough to assuage market anxiety.

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.

Portfolio considerations:

The market reacted violently, with the S&P 500 Index posting its worst one-day loss (-4.3%) in more than two years. Such **inflation-induced volatility has been a key driver of our continued preference for higher quality within equities and makes us reluctant to call the bottom of the bear market.**

While many **equity and fixed income markets have continued to struggle in this "Fedflation" environment,** those seeking temporary refuge might find solace in money market funds yielding 3% for the first time since 2008. But knowing exactly when to cash out and when to cash back in can present its own challenges, as the history of market timing has shown. Instead, holding assets with historically favorable risk/return behavior might be a more effective strategy for managing risk, especially when such assets offer an attractive entry point.

There are still opportunities for investors to find value. Rather than over-relying on cash, Nuveen's leveraged finance team prefers less volatile complements to equities that may benefit from higher short-term rates, such as floating-rate loans. The coupons on such loans are set as a spread over the Secured Overnight Financing Rate (SOFR) and likely to increase alongside Fed rate hikes in the next 12 months (Figure 1).

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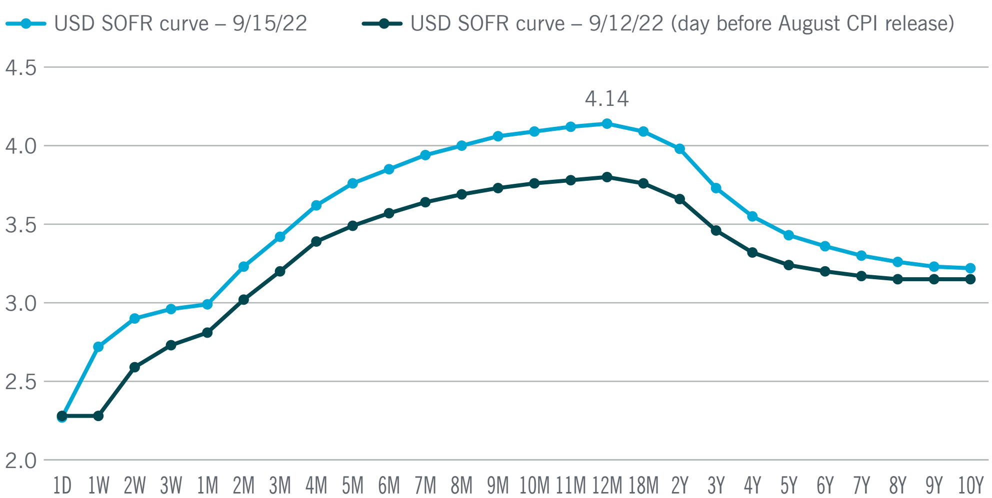
FIGURE 1: A STEEPER (FUNDING COST) HILL TO CLIMB

USD Secured overnight funding rate (SOFR) before and after August CPI release

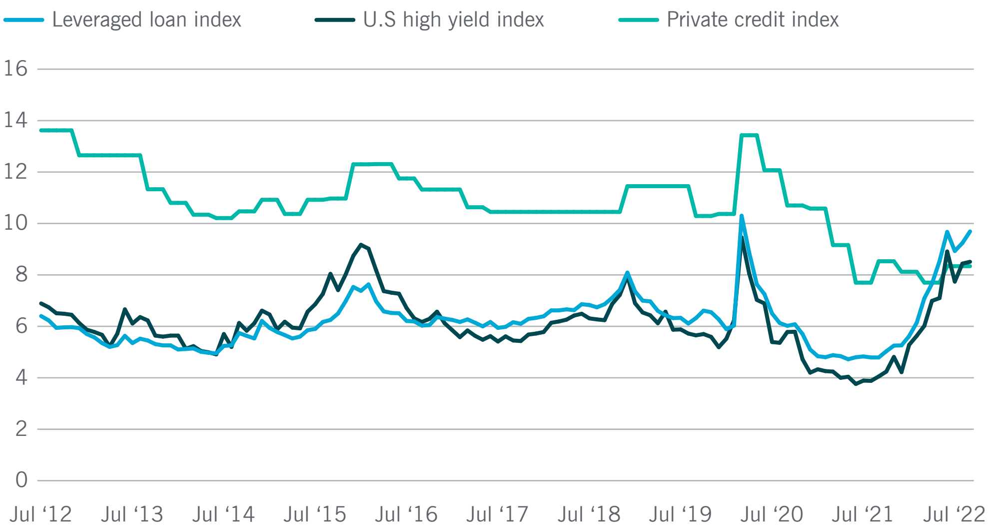


Data source: Bloomberg L.P., 15 Sep 2022. **Past performance does not predict or guarantee future results.**

Of course, higher interest expenses will put pressure on these levered borrowers, already facing headwinds from cost inflation and margin pressure — which is why index level yields today are just shy of 10% (Figure 2). **Overall, though, borrower fundamentals remain solid, with aggregate net leverage back to pre-pandemic levels.** Larger, higher-quality borrowers should be better positioned to withstand higher rates via a combination of inflation rate hedging, stronger balance sheets and less cyclical business models versus lower-quality segments of the market.

FIGURE 2: YIELD OPPORTUNITY IN LOANS?

Index yields are climbing for high yield and loans (%)



Data source: Bloomberg L.P., 31 Jul 2012 to 14 Sep 2022. **Past performance does not predict or guarantee future results.** Representative indexes: **Leveraged loan index:** Credit Suisse Leveraged Loan Index - 3-year yield; **U.S. high yield index:** Bloomberg U.S. High Yield Index - yield to worst; **Private credit index:** Cliffwater Direct Lending Index - 3-year takeout yield.

Middle market direct loans are a similar option. They involve smaller loan sizes to smaller firms in the private market, where lenders may receive better collateral and covenants than with broadly syndicated floating rate loans. Cumulative default rates have historically been lower (4.2%) for middle market loans versus their broadly syndicated counterparts (5.9%), with recovery rates higher, at 73.8% versus 67.3%. These loan term advantages may increase as the Fed continues to pull liquidity from the system. While the yield advantage for middle market loans has been temporarily eclipsed by broadly syndicated loans, the lower default risk makes them worthy of consideration.

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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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