

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Fed hikes as the banking sector collides with inflation

Bottom line up top

Higher rates are contributing to banking issues, and should result in slower growth. Over the past year, the U.S. Federal Reserve has increased rates to counter inflation and restore price stability, moving the fed funds target rate from 0% to between 4.75% and 5.00%. Higher rates have increased the risk of something breaking within the financial system, and have contributed to the crisis of confidence that triggered the high-profile banking collapses. At the same time, investors remain concerned about persistent inflation, especially with a tight labor market putting upward inflation pressures on service industries. Leading up to last week's Fed meeting, markets perceived the central bank's actions to support the banking sector would temporarily ease financial conditions, as markets repriced toward a more dovish approach. Instead, over the intermediate term, we now expect that a lower supply of credit to the U.S. economy will lead to slower economic growth, thus increasing the risk of recession.

The key issue: Inflation remains high and sticky. If banking stresses persist or accelerate, that would have a deflationary effect on the economy, making rate hikes less urgent. If banking issues fade, however, the Fed would be under more pressure to increase rates to combat



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On behalf of Nuveen's Global Investment Committee

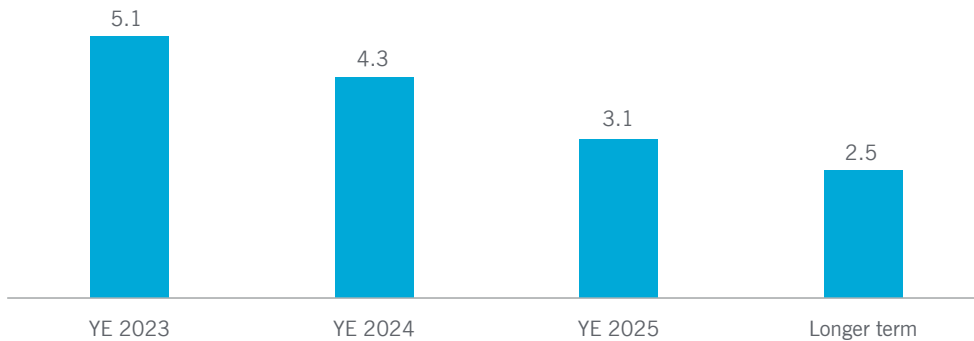
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's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

inflation. With this backdrop in mind, the Fed increased rates by 25 basis points last Wednesday and indicated that, while the Fed aspires for another hike in their dot plot forecast this year, disinflationary events will require continual monitoring (Figure 1). In our view, this helps confirm that investors are facing a “higher-for-longer” rates environment.

With the Fed caught between financial market pressures and inflation, the rates outlook is less certain.

FIGURE 1: RATES MAY BE RELATIVELY HIGH FOR SOME TIME

Implied fed funds target rate (%)



Data sources: Bloomberg L.P. 22 March 2023. Performance data shown represents past performance and does not predict or guarantee future results.

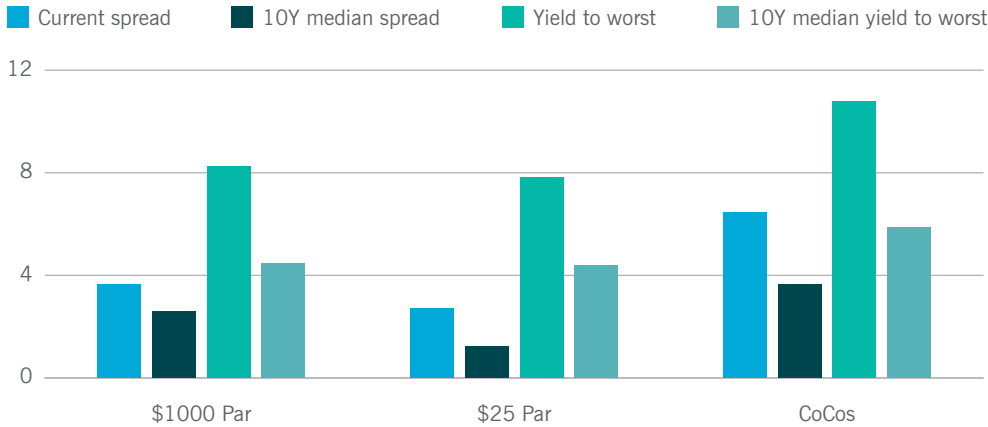
Portfolio considerations

Throughout the year, we have recommended defensive positioning across equities and a preference to allocate risk within fixed income. Carrying this view across the banking sector leads us to favor preferred securities over U.S. bank common stock. Over the past decade, U.S. bank stocks have experienced high levels of volatility, with drawdowns exceeding 10% more than 10 times. On the other hand, preferred securities have only seen drawdowns of 10% or more twice: at the onset of the pandemic in March 2020 and what we are seeing now.

This current move in preferred securities is unprecedented, as spreads over Treasuries widened 122 bps between 28 February and 20 March. If the spread finishes this month at its current level, it would represent the third-largest monthly increase since the inception of the ICE BofA All Capital Securities Index in 2012. At present, we think the preferred sector offers attractive valuations. Within preferreds, we favor \$1,000 par over \$25 par preferred securities, as they offer more attractive valuations and feature almost one-third less duration (Figure 2). We also think the \$1,000 par side of the market should be more liquid and less volatile.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

FIGURE 2: RELATIVE VALUATIONS MAKE \$1,000 PAR PREFERRED PARTICULARLY ATTRACTIVE



Data source: Bloomberg, L.P. 20 March 2023. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$1,000 Par: ICE US Institutional Capital Securities Index; \$25 Par: ICE BofA Core Plus Fixed Rate Preferred Securities Index; CoCos: ICE USD Contingent Capital Index. Yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Additionally, in the wake of the Credit Suisse takeover, we remain constructive toward tier-one contingent convertible bonds (AT1 CoCos) issued by European banks (outside of Switzerland), as regulators and central banks governing those areas explicitly recognize AT1 CoCo investors as being senior to common equity investors. The recent experience with Credit Suisse has forced spreads wider across the entire AT1 CoCo market, which we believe has created attractive valuations.

The unprecedented move in preferred securities may have created some value.

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 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. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Investing in preferred securities entails certain risks, including preferred security risk, interest rate risk, income risk, credit risk, non-U.S. securities risk and concentration/nondiversification risk, among others. There are special risks associated with investing in preferred securities, including generally an absence of voting rights with respect to the issuing company unless certain events occur. Also in certain circumstances, an issuer of preferred securities may redeem the securities prior to a specified date. As with call provisions, a redemption by the issuer may negatively impact the return of the security held by an account. In addition, preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore will be subject to greater credit risk than those debt instruments.

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This information does not constitute investment research as defined under MiFID.

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NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE