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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Farmland: Cream of the inflation hedge crop?

Bottom line up top

Inflation's hitting the high notes. *Oklahoma*!, Rodgers and Hammerstein's 1943 musical, yielded a bounty of now-ingrained cultural references, including the expression "as high as an elephant's eye." Today, that analogy applies not only to tall cornstalks but also to inflation — which still looms above the 2% target set by numerous central banks. In the U.S., year-over-year headline inflation stands at 4.9% and 4.4%, as measured by the Consumer Price Index and Personal Consumption Expenditures Price Index, respectively. At this point, the Federal Reserve isn't quite ready to let its higher-for-longer rate landscape lie fallow.

Employment data is writing the score. What might make the Fed change its tune? More slack in the labor market. The number of open jobs and the availability of workers to fill them remains out of whack, putting upward pressure on wages, an important factor in the inflation equation. U.S. job openings increased to 10.1 million in April — far more than consensus expectations and nearly double the historical average. In contrast, the job quits rate declined for the second consecutive month. This metric typically leads wage growth by two to three quarters and may be a more useful gauge of labor market tightness.

Weekly first-time unemployment claims have been moving sideways (Figure 1). For the most recent reporting week, they ticked up to 232,000 but were lower than forecast. Notable movement in one direction or the other could offer a clue as to the Fed's next move.

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.

Monthly payrolls show a hot labor market that isn't cooling fast enough for the Fed to consider rate cuts, but we could see a pause this month as the central bank takes time to interpret the data. Employers added a shockingly high 339,000 new jobs in May, while average hourly earnings rose 4.3% year-over-year, a tick lower than in April but still a healthy gain. One sign of weakness: The unemployment rate climbed to 3.7%.

You can't reap if you don't sow. Despite labor market resilience and optimism amid last week's deal to avert a U.S. government default, we still foresee a mild U.S. recession, although it's likely been delayed from late 2023 until some time in 2024, as the growth-dampening effects of tight monetary policy work their way through the economy. In the meantime, with high inflation likely to persist, we think investors would be well-served by allocating to real assets that can provide meaningful inflation protection. Farmland could be a good place to start.

Given still-strong upward pressure on wages, we don't anticipate the Fed will be looking to cut rates in the near future.

FIGURE 1: WATCHING THE JOB MARKET FOR POLICY CLUES

U.S. weekly initial jobless claims (thousands)

Data source: FactSet, U.S. Department of Labor. 4 Sep 2021 to 25 May 2023.

Portfolio considerations

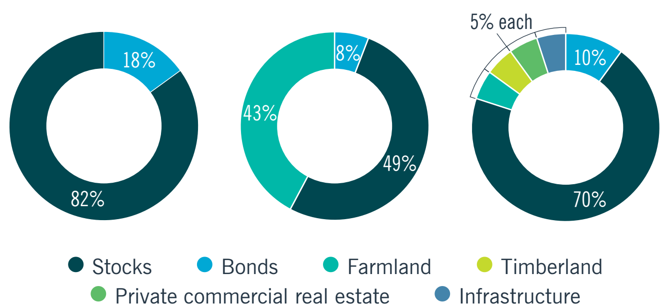
Real assets — historically an effective hedge against inflation — appear well-suited for the current backdrop. Many commodities, such as foodstuffs and raw materials, are components of inflation measurements. As their prices rise, so do the revenues and cash yields for real assets producing these commodities. Additionally, areas such as farmland and timber tend to be less affected by factors that cause day-to-day swings in stock and bond markets, offering a potential source of portfolio diversification.

Investors should consider how much to allocate to real assets, the ability of the asset class to generate attractive risk-adjusted returns and the overall correlations within a portfolio. Figure 2 compares the historical performance of a traditional portfolio consisting of stocks and bonds to portfolios that include real assets, including farmland. While adding farmland on its own significantly improved the historical Sharpe ratio (a measure of risk-adjusted return), other categories of real assets provided benefits as well. Our analysis showed that allocating 5% each to farmland, timber, real estate and infrastructure would have offered compelling results.

Real assets, including farm-land, offer the potential to improve risk-adjusted returns in a portfolio.

FIGURE 2: FARMLAND AND OTHER REAL ASSETS MAY IMPROVE PORTFOLIO EFFICIENCY

Allocation representing highest risk-adjusted return, based on Sharpe ratio



	100% Traditional portfolio	Adding only farmland	Adding four categories of real assets, fixed at 5% each (20% combined)
Average annual total returns (%)	6.80	8.45	7.05
Standard deviation (%)	4.48	3.28	3.52
Sharpe ratio	0.94	1.78	1.27

Data source: FactSet. Data are based on rolling one-year total returns, calculated on a quarterly basis for periods ended 31 Mar 1991 through 31 Dec 2021. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: Stocks:** Russell 3000 Index and MSCI ACWI ex USA Index; **Bonds:** Bloomberg U.S. Aggregate Bond Index and Bloomberg Global Aggregate Bond Index; **Farmland:** NCREIF Farmland Index; **Timberland:** NCREIF Timberland Index; **Private commercial real estate:** NCREIF Real Estate Index; **Infrastructure:** Cambridge Developed Markets Infrastructure Index (data from 30 June 2003). **Standard deviation** is a statistical measure of historical volatility; the higher the number, the greater the risk. **Sharpe ratio** is a risk-adjusted return measure calculated using standard deviation and excess return to determine reward per unit of risk. The higher the Sharpe ratio, the better the historical risk-adjusted performance.

Lastly, in addition to hedging inflation, real assets can potentially enhance the defensive posture of a portfolio, making them worthy investment candidates in advance of a possible recession. Farmland and infrastructure, for example, provide basic necessities, so the demand for the goods and services they produce should be resilient in a weakening economic environment.

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. 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. Investors should be aware that alternative investments 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. 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. Real asset investments may be subject to environmental and political risks and currency volatility.

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