

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Can earnings continue to bend without markets breaking?

Bottom line up top

Like a rocket's red glare, equity markets have been giving off a lot of heat. Few investors battered by dismal performance across asset classes in 2022 could have predicted how fired up global equities would be in the first half of 2023. Broad-based stock market indexes, both U.S. and non-U.S., delivered year-to-date gains through June, ranging from mid-single digits to well over 30%. While the biggest individual winners were mostly in technology and other growth-oriented industries, given the explosive interest in artificial intelligence trends, the rally gradually broadened. This occurred particularly in the U.S., where all but four of the 11 S&P 500 Index sectors posted positive first-half returns. Supporting this performance was a combination of moderating inflation, less aggressive U.S. monetary policy, signs of economic resilience and less-negative-than-feared corporate earnings results.

Broad stripes and bright stars. Although first quarter earnings growth for S&P 500 companies was negative overall (-2.2%), it nonetheless exceeded consensus forecasts. Second quarter earnings for the index as a whole also look poised to decline (-7.2%, according to FactSet estimates). This would extend the earnings recession to three consecutive quarters and mark the largest earnings drop since the second quarter of 2020 (-31.6%). Disparity among sectors continues to be a familiar theme since the Covid economic lockdowns three years ago, with earnings growth projections (Figure 1) highest for the consumer discretionary sector (+27.0%) and lowest for energy (-48.4%) amid slumping oil prices.



Saira Malik, CFA
Chief Investment Officer

On behalf of Nuveen's Global Investment Committee

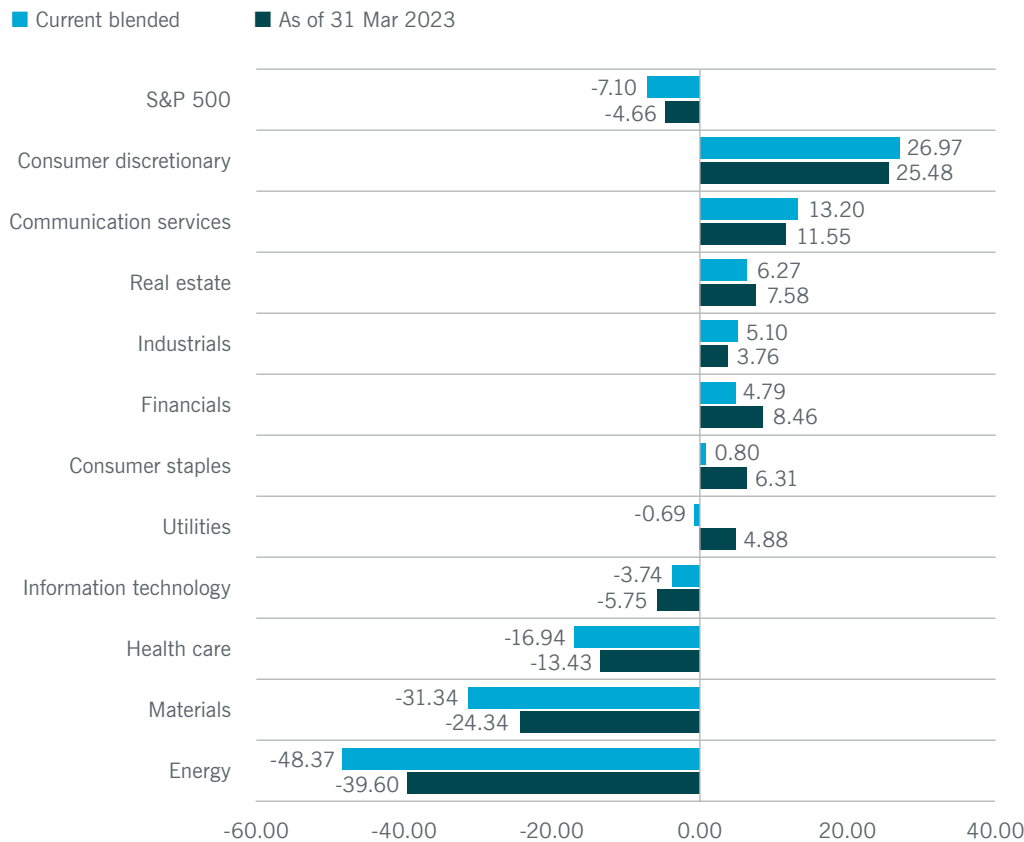
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's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

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FIGURE 1: EARNINGS ESTIMATES CONTINUE TO CREEP LOWER

S&P 500 second quarter 2023 earnings growth estimates (%)



Data source: FactSet, 05 July 2023. Blended earnings growth estimates combine the actual results of companies that have reported 2Q23 earnings with current estimates of companies that have yet to report.

Earnings growth looks poised to decline for the third quarter in a row and may mark its biggest drop since the second quarter of 2020.

Portfolio considerations

Another lowered bar, another grain of salt. With analysts cutting 2Q earnings estimates in recent weeks (Figure 2), companies may once again find it easier to deliver stronger-than-expected results. We are cautious about the self-fulfilling optimism driven by these diminished expectations, seeking to balance equity allocations between areas of the market where we want to add beta and others that we believe can provide downside protection. Additionally, we’re mindful of mixed U.S. economic data and the potential for two more rate hikes this year.

From a **beta perspective**, we favor emerging markets (EM) equities and U.S. publicly traded real estate investment trusts (REITs).

- Within EM, we consider Brazil and Mexico attractive. Both countries are currently experiencing high nominal and real interest rates, with decelerating inflation. The Central Bank of Brazil recently hinted that it might cut rates as early as August — a possible catalyst for further gains in Brazilian equities.

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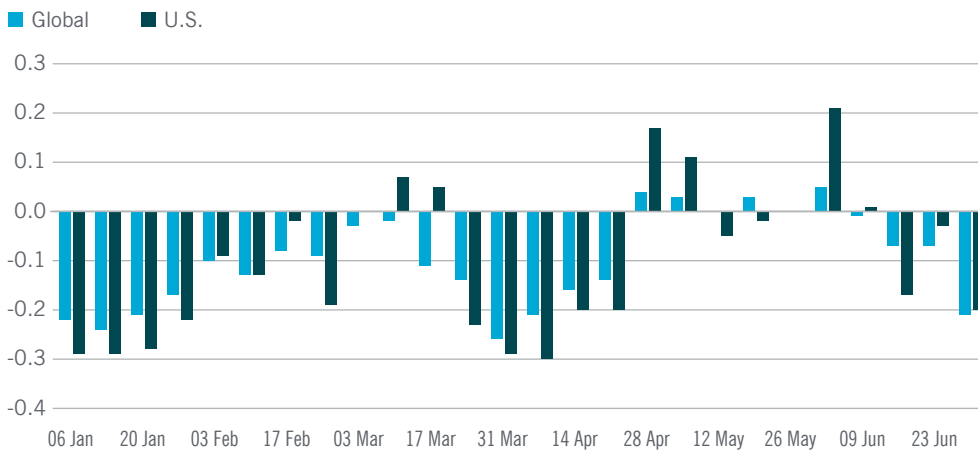
For downside management in a portfolio, we continue to emphasize dividend growth equities.

- U.S. public REITs are trading at a relatively wide discount to net asset value: -16% on an equal-weighted basis and -6% on a market-weighted basis, compared to long-term averages of -1% and 6%, respectively (Source: Green Street, 30 June 2023). In addition, REITs' earnings growth is less cyclical than that of the broader equity market, thanks to long-term lease contracts with fixed or CPI inflation-linked escalators. Lastly, strong fundamentals support dividends going forward. The REITs dividend coverage ratio, which measures the ability of a REIT to pay similar or higher dividends in the future, is at 150%, versus approximately 120% pre-pandemic, according to Green Street.

For **downside management** in a portfolio, we continue to emphasize dividend growth equities. These companies offer compelling relative yields, tend to be of higher quality and also have the ability to reinvest cash into their businesses. According to S&P, more than 180 S&P 500 companies have declared a dividend increase so far in 2023. Strong dividend activity in the face of cost pressures may signal a company's confidence in its business prospects.

FIGURE 2: ANALYSTS ARE SLASHING EARNINGS ESTIMATES AHEAD OF RESULTS

Global and U.S. earnings revision indexes (%)



Data source: Bloomberg L.P., 30 June 2023. **Representative Indexes:** Global: Citigroup Global Earnings Revisions Index; U.S.: Citigroup U.S. Earnings Revisions Index.

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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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Nuveen, LLC provides investment solutions through its investment specialists.

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