

## Viewpoints from the Global Investment Committee

MIDYEAR | 2023 OUTLOOK

# Testing the waters

## *From waiting it out to wading in*

### KEY TAKEAWAYS

1

**Still-high inflation, fear of stagnation, rate equivocation cause uncertainty.** Investors are keeping cash on the sidelines.


2

**Hesitation or delaying rebalancing are rarely winning strategies.** Waiting for greater clarity has risks of its own.

3

**What's more compelling than cash?** We see opportunities in select areas of equities, fixed income, real estate and real assets.





## Global Investment Committee members

**Saira Malik**  
*CIO, Nuveen*

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# Testing the waters

## *From waiting it out to wading in*



### Saira Malik

#### Chief Investment Officer

*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.*

Our previous outlook, *Caught in a holding pattern*, likened the quandary of investors seeking a place to put their money to the plight of a plane circling until cleared to land. A similar sense of delay persists today. Many wary market participants are sitting on high levels of cash and cash equivalents. Their rationale: Better to stand safely on shore — and earn what looks like a decent yield in today's higher interest rate environment — than risk swimming in choppy and uncharted waters.

But when does an abundance of caution turn into missed opportunity? How long is too long to wait for a return to “normal”? And what, exactly, will normal look like across economies and markets?

Inflation stands front and center in this discussion. Historic rate hikes from the U.S. Federal Reserve and other central banks have helped bring inflation down considerably from its 2022 peaks. Even so, inflation in most areas of the world still exceeds the long-term 2% target set by policymakers — potentially signaling that inflation has become structurally higher.

The era of ultra-low interest rates is also clearly behind us. Rates continue to hover at relatively lofty levels, and the Fed is not yet poised to pivot from its tightening trajectory. Staying the Fed's hand is a resilient labor market with persistently solid wage growth and what may be structurally lower unemployment. Meanwhile, the Fed's still-hawkish tone has many investors assessing if and when the U.S. will fall into a recession. Growing concern that the dominance of high-flying technology stocks has made this year's U.S. equity market rally too narrow for comfort is also fostering reluctance to participate.

Investors daunted by this uncertain environment needn't — and in our view, shouldn't — stay on the sidelines indefinitely. We suggest a judicious approach to putting cash back to work, focusing on these key tenets:

**Dip a toe in first.** Water safety specialists recommend gradually wading into a body of water versus diving right in. The same principle applies to investment markets that appear too murky or volatile for full immersion. Investors seeking a yield advantage without plunging into full risk-on mode should consider select areas of the broad bond market, including municipals.

**Explore international waters.** We continue to see opportunities in emerging markets equities given attractive valuations, the weaker U.S. dollar and looser monetary policy in China. In credit markets, Europe may provide an edge over the U.S. given the strength of the region's banking system. We're also identifying ample investment ideas in infrastructure, real estate and other real assets across the globe.

**Find an oasis in real estate.** The harsh glare of headlines about the beleaguered office sector has created the mirage that all real estate assets should be avoided. But closer scrutiny reveals true pools of potential, particularly in the industrial and multifamily sectors.

The following outlook includes our more detailed map of the economic and market landscape at midyear 2023, with directions to investment destinations where the water may prove warmer and more inviting than in others — provided swimmers exercise caution and stay aware of their surroundings.



## Portfolio construction themes

*The investment environment remains cloudy. While aggressive rate hikes may finally be behind us, we don't expect rate cuts before the end of 2023, meaning investors must still contend with the "higher-for-longer" rate environment. And recession odds have increased, although we don't anticipate a long or deep contraction. This backdrop is causing many investors to avoid taking action. **Continuing to wait it out, however, is likely a mistake, as it carries its own risks. Our portfolio construction themes suggest a number of investment ideas that look better than simply holding cash.***

## Asset class “heat map”

Our cross-asset class views indicate where we see the best relative opportunities within global financial markets. These are not intended to represent a specific portfolio, but rather to answer the question: “What are our highest-conviction views when it comes to putting new money to work?” These views assume a U.S. dollar-based investor seeking long-term growth and represent a one-year time horizon.



The views above are for informational purposes only and compare the relative merits of each asset class based on the collective assessment of Nuveen's Global Investment Committee. They do not reflect the experience of any Nuveen product or service. Upgrades and downgrades reflect quarterly shifts in these views.



## Portfolio themes

- **Dip a toe in first to get out of cash:** This is the primary investment theme coming out of our recent GIC meeting. We know many of our clients are sitting on large cash allocations, either because they are awaiting enhanced clarity about the economy or because they believe that receiving nearly 5% returns from cash is a viable low-risk option. But with inflation starting to moderate and growth likely to slow, cash yields are unlikely to stay that high, creating reinvestment risk. The bottom line is we see more compelling opportunities in select areas of the global financial markets.

For those looking to increase yield without moving into full risk-on mode, we think it makes sense to explore areas of the broad bond market, including municipals. Figure 1 shows the returns of various asset classes during different rate and inflation environments. And while the past doesn't guarantee the future, history suggests that core fixed income and municipals are solid "cash off the sidelines" candidates (1) in periods following rate hikes (when their effects are working through the economy) and (2) when rates are being cut amid economic weakness.

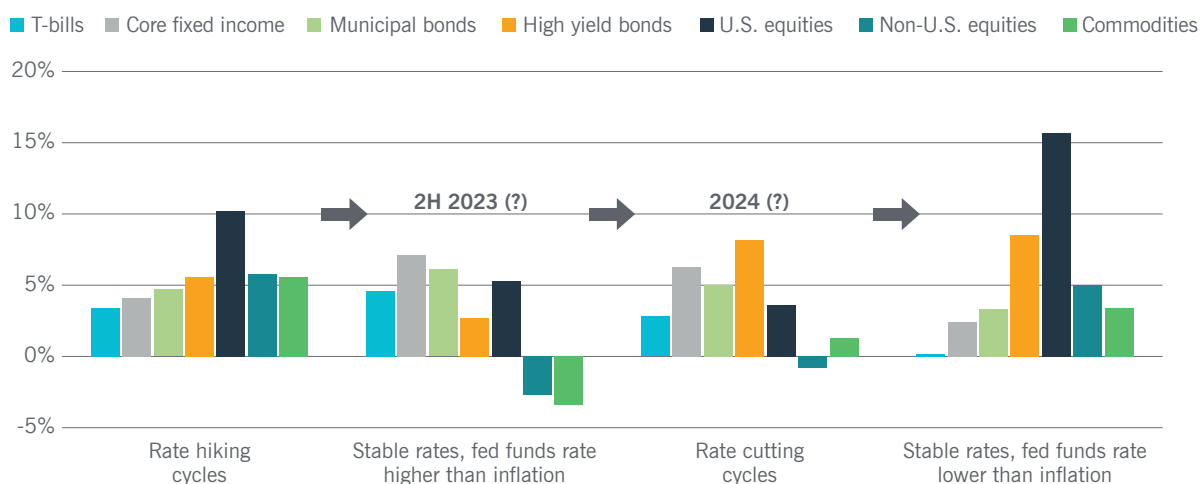
A number of other areas also offer favorable risk/reward tradeoffs, as detailed below and in our "best ideas" section of this outlook.

- **Explore international waters:** A second clear theme that emerged from our GIC discussions is that investment ideas from outside the U.S. are worth exploring.

In equities, we suggest balancing the benefits of U.S. large caps (which we think will perform well given moderating inflation, stabilizing yields and tailwinds from the tech sector) with those in emerging market equities (where we see tailwinds from attractive valuations, the weaker dollar and looser monetary policy in China). We'd also point to Europe's banking sector, which is stronger than its U.S. counterpart, as a potential source of promising opportunities in European stocks and bonds alike. Additionally, we see attractive investments in non-U.S. alternatives, including real estate and real assets.

- **Find an oasis in real estate beyond the office:** The recent banking sector crisis (and continuing associated uncertainty) has many investors wondering if the real estate office sector will be the next figurative shoe to drop, and how office property dynamics could impact their

**Figure 1: What beats cash in different rate and inflation environments?**  
30-year annualized average returns



Data source: Bloomberg, L.P., U.S. Federal Reserve, Bureau of Economic Analysis, 30-year annualized monthly returns for each asset as of 31 May 2023, divided into four environments. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: T-bills: ICE BofA U.S. 3-Month Treasury Bill Index; core fixed income: Bloomberg U.S. Aggregate Total Return Index; municipal bonds: Bloomberg Municipal Bond Index; high yield bonds: Bloomberg U.S. Corporate High Yield Total Return Index; U.S. equities: S&P 500 Index; non-U.S. equities: MSCI All Country World ex-U.S. Index; commodities: Bloomberg Commodity Total Return Index; fed funds rate: federal funds target rate - upper bound; core PCE Inflation: U.S. Personal Consumption Expenditure Core Price Index year-over-year, seasonally adjusted. Hike: months where the fed funds rate was 25 bps or higher than the minimum fed funds rate over the previous five months. Cut: months where the fed funds rate was 25 bps less than the maximum fed funds rate over the previous five months. Stable: months when the fed funds rate was unchanged for a six-month period.

portfolios. We expect challenges in this sector to persist, but we don't foresee broad financial contagion as a result. Office vacancy rates, while high, tend to be concentrated geographically, and U.S. regional banks that are already under pressure generally don't have exposure to large office buildings or complexes. Outside of the office sector, real estate fundamentals look strong.

Looking past office-related headlines uncovers some interesting possibilities for real estate. We are largely focused on non-office public and private real estate sectors, including retail, housing, industrial and alternative areas. Public REITs are especially worthy of consideration based on favorable valuations and relative earnings, along with dividend stability and solid balance sheets.

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## A close look at credit

- **Public markets fixed income** should fare well once it becomes evident that a recession is getting under way and that rates are going to fall.
- We think **private credit** stands to benefit amid prospects for only a mild recession. In fact, current private credit vintages could be especially attractive, as today's financial conditions make them more defensively constructed.
- Lastly, a word on **preferred securities**, which we've downgraded a notch in our heat map. While preferred valuations have improved given the selloff related to bank failures, the banking sector and the asset class as a whole remain challenged.

Importantly, though, we see select opportunities in non-U.S. bank and other issuers, including insurance, utilities, midstream energy companies and some super-regional U.S. banks.

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## Our highest-conviction views

- **Infrastructure (+)** has long been a favored area for us. Still-high inflation helps the asset class on a relative basis, and infrastructure tends to be resilient in the face of slowing economic growth. We have a modest preference for publicly listed over private infrastructure, which still might experience price lag effects as privates catch up to what public markets experienced last year.
- **Private credit (+)** faces some slowing in new deal issuance, but fundamentals remain sound. These investments tend to focus on more resilient areas of the market such as health care, software and insurance brokers — all of which are relatively well-positioned to withstand economic downturns.
- **Municipals (+)** remain a favored area where we think it pays to take on credit risk. Fundamentals are strong, demand has returned to the market and valuations look reasonable.

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**We see a wide range of investment ideas that appear more compelling than cash.**

# The economy and markets

## Key points to know

### *Recession? Probably, but not yet.*

The global economic expansion is three years old — young compared to history, as the last three growth cycles lasted an average of nine years. But expansions don't die of old age; they usually end due to an external shock, often from monetary policy. With that in mind, the odds of a global recession can't be discounted, especially after many central banks have spent the past year resolutely raising rates to battle inflation. In the U.S., many leading indicators have softened (including the ISM manufacturing survey and lending activity), while the Treasury yield curve remains inverted. This points to the likelihood of a U.S. recession of limited magnitude and duration in the medium term. Outside the U.S., the eurozone economy has already contracted slightly for two consecutive quarters, and the U.K. is also flirting with negative growth. We don't expect a long or severe global recession, but our base case calls for a mild one emerging in 2024.

### *Inflation and the labor market: all gain, no pain.*

Heading into 2023, we believed further easing of inflation was in store, accompanied by weaker growth and higher unemployment. While inflation has indeed moderated so far this year, economies have not yet paid a substantive price in terms of labor market or broader economic pain. In fact, GDP growth accelerated in the U.S., Europe and China in the first quarter. Across developed market economies, unemployment remains broadly lower than it was pre-Covid (Figure 2). With housing inflation starting to roll over and oil prices down nearly 30% from a year ago, the ingredients for benign disinflation are coming together. That said, continued progress will be uneven, and we still expect U.S. core inflation to be near 4% at year end — double the Fed's 2% target.

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**We expect a mild global recession to materialize in 2024.**





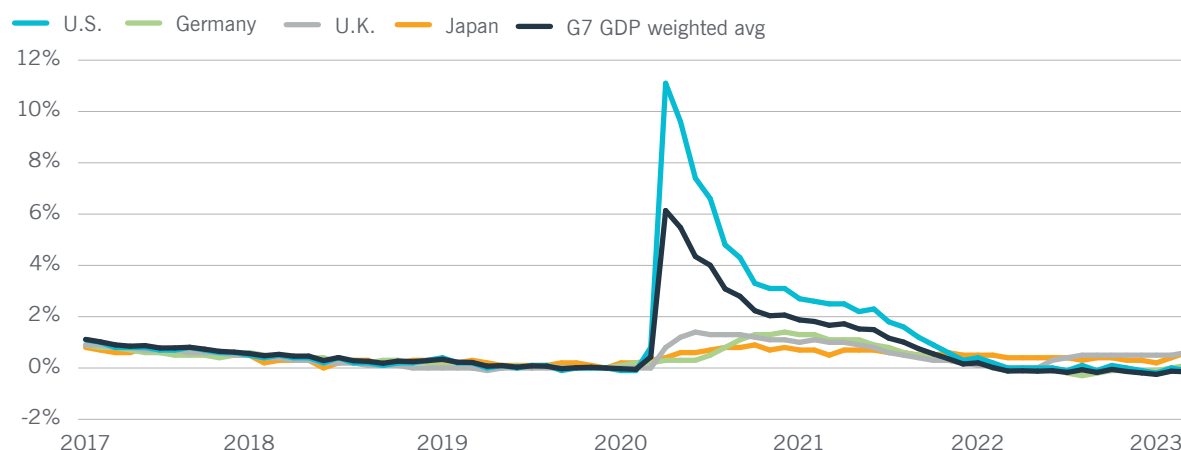
## Interest rate cuts aren't coming soon.

With labor markets remaining resilient and inflation moderating, some investors are betting on rate cuts in the second half of the year. We think that projected time frame is too early. Policymakers are unlikely to flinch in their fight against inflation unless it returns to its target level or the employment situation begins to show more worrying signs of weakness. We don't expect either of these to happen until the end of 2023 at the earliest. On the contrary, additional rate hikes are more likely than rate cuts this year if the economy continues to perform well and the eventual recession doesn't arrive until sometime in 2024, per our current outlook.

## Keep an eye on the tail risks.

Investors should stay mindful of various upside and downside risks that have the potential to complicate our base case for a mild recession. Among the downside risks: A deeper-than-anticipated downturn would probably cause central banks to start reversing their aggressive 2022 rate hikes. In addition, while the direct impact of recent banking stress appears to have been relatively modest (we estimate a -0.5% hit to 2024 U.S. GDP growth from tighter lending conditions), financial system uncertainty will persist, perhaps exerting a bigger drag. Such a result would favor more defensive portfolio positioning. On the upside, if stronger growth materializes, central banks may nudge interest rates higher from current levels. In this scenario, risk assets should perform well. Importantly, we wouldn't expect cash to outperform in either scenario.

**Figure 2: Global labor markets remain extremely healthy**  
*Developed markets unemployment rates, indexed to zero at Dec 2019*



Data source: Bloomberg, L.P., 01 Jan 2017 to 31 Mar 2023.

**EQUITIES****Saira Malik****Investment positioning**

- We remain neutral overall toward equities as markets continue to face headwinds — even as those winds are shifting. Inflation remains elevated but is starting to moderate, while interest rates appear to have stabilized at a relatively high level. Today, we are increasingly focused on the prospects for a recession and have concerns about some companies' abilities to maintain pricing power, which could challenge revenues and earnings. In this environment, we expect continued volatility and uncertainty, and we favor overall defensive positioning combined with select risk-taking.
- Specifically, we think U.S. large cap equities remain a relative safe haven and believe large/mega cap technology companies (the main market driver this year) look relatively well positioned for disinflation and slowing growth. Emerging markets have become more attractive due to compelling valuations, solid earnings prospects and the joint tailwinds of a weaker U.S. dollar and easier monetary policy in China. We remain cautious toward U.S. small caps, as we expect this area may underperform ahead of a recession.
- Across geographies and sectors, we are looking for ways to shift from a more defensive posture toward higher-quality cyclical areas with solid cash flows. We think these areas could be poised to outperform once the economy has clearly entered a recession, as they could lead an economic upswing.
- In private equity, we see select opportunities, but valuations as a whole appear unclear and many investors continue to hold off on allocations as recession worries rise.

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**BEST IDEAS:** *Our highest-conviction investment idea continues to be dividend-growers, which tend to be high quality companies that have strong free cash flow levels. This area of the market also offers solid income and tends to be less susceptible to volatility.*

**FIXED INCOME****Anders Persson****Investment positioning**

- Broadly speaking, the risk/reward tradeoff for fixed income assets looks attractive. The era of aggressive interest rate increases appears to be over. And while rate volatility may remain high (especially on the front end of the curve), we think the 10-year Treasury yield should remain range-bound between 3.25% and 3.75%. We anticipate a mild recession and believe any weakness across taxable and municipal markets in advance of a recession could represent an even more attractive entry point if spreads widen.
- Within taxable fixed income markets, we think it makes sense to reduce short-duration positions and move closer to neutral given that rates have peaked for the cycle. Additionally, we are focused on higher-quality segments of individual asset classes (for example, in U.S. high yield, BB rated areas look more compelling than B or CCC rated).
- Additionally, we suggest an overall emphasis on flexibility and diversification across credit sectors versus over- or under-allocating to any one area, as we see solid (if idiosyncratic) opportunities across the global taxable fixed income market. Within that context, however, we continue to favor the higher-quality areas of high yield. And, as mentioned earlier, preferred securities as a whole continues to face difficulties from banking sector issues.
- In municipal markets, we think fundamentals remain sound, with state and local governments flush with cash. Credit quality looks healthy and valuations remain reasonable for both investment grade and high yield bonds.
- We are generally focused on longer duration across the municipal yield curve and see value in adding credit risk across the market thanks to the favorable backdrop.
- We are highly constructive toward private credit markets, especially in the event of only a shallow recession.

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**BEST IDEAS:** *Within taxable fixed income, our highest-conviction idea remains a flexible and diversified multisector approach, with a focus on higher-quality credits across sectors. For municipal bonds, we see compelling opportunities in both high yield credits and bonds with maturities greater than 15 years, which appear relatively undervalued.*



## REAL ESTATE

Carly Tripp

### Investment positioning

- The headwinds putting pressure on private real estate markets over the last year remain, but we think they are starting to fade. Deal activity remains subdued, liquidity has been scarce and borrower defaults are still increasing (primarily in the office sector). Real estate fundamentals still look supportive, but the negative technical factors may continue to drive markets for now. Our best bet is that the negatives will recede over the next couple of quarters.
- In this environment, we continue to favor real estate debt over equity, as the interest rate environment appears to be stabilizing. In particular, we prefer the industrial and housing sectors.
- We also continue to see idiosyncratic opportunities across geographies. In the U.S., we like affordable housing given solid government support, as well as specialized medical offices that benefit from aging demographics and the steady trend toward outpatient procedures; we favor European suburban housing (specifically rentals) in areas experiencing growing industrialization; and in Asia we prefer investments benefiting from demographic trends such as Tokyo senior living facilities and Australian student housing.

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**BEST IDEAS:** *In addition to the above, we remain focused on “global cities” experiencing growing, educated and diverse populations, especially in the health care, industrial and housing sectors.*

## REAL ASSETS



Justin  
Ourso



Jay  
Rosenberg

### Investment positioning

- For some time, Nuveen’s Global Investment Committee has favored public infrastructure investments, and that theme continues. Fundamentals remain solid and defensive, while valuations look fair. In particular, we favor North American

utilities and waste companies, and we see attractive opportunities in European and Asian utilities as well. We are also increasingly focused on investment grade debt issued by infrastructure companies that offer attractive yields and solid credit conditions.

- As detailed previously, public real estate offers favorable valuations and should benefit from the end of Fed tightening. We prefer companies with strong balance sheets, superior access to capital and property holdings in sectors with positive fundamentals in this high interest rate and inflationary environment. These include owners of shopping centers, industrial properties and senior housing. We remain wary of the office sector.
- Despite higher costs of capital, private infrastructure stands to benefit from the strength of many underlying business and/or asset fundamentals, as well as still-high inflation. We’re seeing the best opportunities in investments that capitalize on the ongoing shift from fossil fuels to green electrification.
- Farmland remains an attractive asset class, with row crop appreciation expected to continue throughout 2023. We also see value in agribusiness companies, particularly pet food producers. We like timberland investments as well, as they should get a boost from increased housing demand.
- The commodities landscape is showing signs of improvement given a more stable interest rate environment, but we are not yet expecting a new commodities bull market.

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**BEST IDEAS:** *In public markets, our best ideas in infrastructure are regulated utilities, waste and pipelines; in real estate, we are focused on shopping centers and senior housing. In private markets, we still favor investments that align with climate transition, such as clean energy, renewable fuel sources and continued strong global demand for protein and healthy foods.*



## 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. Quarterly 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](http://nuveen.com).**

### Endnotes

#### Sources

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

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