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CIO Weekly Commentary
12 February 2024

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Magnificent munis

Bottom line up top

Magnificent Seven becoming vulnerable? Last year, mega cap leaders Apple, Amazon, Alphabet, Meta Platforms, Microsoft, NVIDIA and Tesla — collectively known as the Magnificent Seven — saw strong performance (+107%) as a group, accounting for approximately two-thirds of the S&P 500's 26.3% total return. They've also delivered outsized outperformance since the onset of the pandemic (Figure 1). This performance dispersion has led to a disproportionate increase in stock valuations of the Magnificent Seven relative to the rest of the market. As we move forward into 2024, investor expectations for continued strong earnings and profits from these juggernauts have raised the bar for further gains. The adoption speed of generative artificial intelligence (AI) will also help determine their path. Ultimately, we believe investors may have reached an inflection point. Not only is the dominance of the Magnificent Seven vulnerable to pullbacks, but the overall equity market is looking for a catalyst to move higher following the current earnings season.

Therefore, consider diversification. At the same time, although inflation has continued to moderate, the U.S. Federal Reserve has pushed back on cutting interest rates until it has "greater confidence that inflation is moving sustainably down to 2%," namely, the central bank's target. Against that uncertain backdrop, investors with significant exposure to the Magnificent Seven may want to consider diversifying toward asset classes that were left behind in last year's broad rally, yet still offer attractive risk/reward profiles. In our view, that calls for taking advantage of the opportunities in fixed income — municipal bonds in particular.

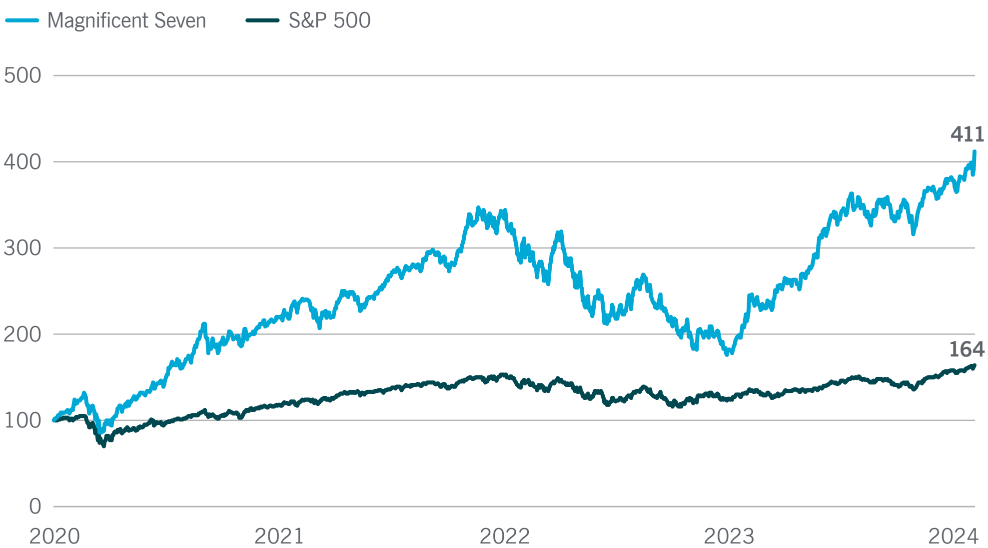
Saira Malik, CFA
Chief Investment Officer

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.

FIGURE 1: MEGA CAP LEADERS DOMINATE PERFORMANCE

Magnificent Seven vs. S&P 500 Index



Data sources: Strategas, Bloomberg L.P., 05 Feb 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Indexed to 100 on 01 Jan 2020.

> ***Not only is the dominance of the Magnificent Seven vulnerable to pullbacks, but the overall equity market is looking for a catalyst to move higher following the current earnings season.***

Portfolio considerations

U.S. Treasury yields have risen across the curve in 2024, with the 10-year yield now more than 4%. Anticipating a slowdown in economic growth, we forecast the 10-year yield to end 2024 at around 3.50%. The expected decline in yields should reward investors who extend duration in fixed income, especially in the tax-exempt space. Municipal-to-Treasury yield ratios have risen year-to-date, meaning AAA rated municipals with maturities from 1-10 years yield roughly the same as similar U.S. Treasuries on a taxable-equivalent basis (Figure 2). High quality municipals present an attractive opportunity for those overallocated to cash. We expect Treasury yields to decline and for investors locking in yields now to be rewarded.

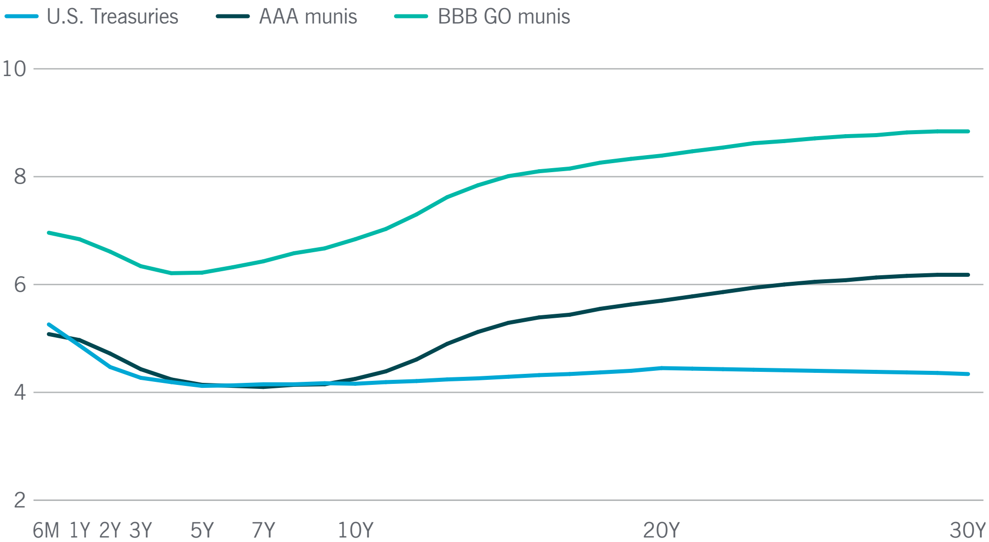
Additionally, we see compelling value in lower-quality investment grade (BBB) munis, which are yielding nearly 200 bps more than their AAA muni counterparts across short- and long-term maturities. For those willing to take on credit risk, up-in-quality high yield municipals could deserve an allocation in a portfolio.

This sector also offers longer duration than investment grade munis. Year-to-date, high yield mutual fund flows have turned positive and new issue deals are largely oversubscribed, with mutual fund demand exceeding supply. Supply is expected to stay constrained, and we expect credit spreads to remain stable, with default rates low and idiosyncratic. Both fundamental and technical catalysts support the high yield muni market.

With the start of tax season, municipal selling typically occurs mid-March through the second week of April. Investors should take advantage of any technical weakness that may occur over this relatively short window.

FIGURE 2: MUNICIPAL CURVE FAVORS EXTENDING DURATION

Taxable-equivalent yield curve (%)



Data source: Bloomberg, L.P., 05 Feb 2023. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes**: **U.S. Treasury**: U.S. Treasury Actives curve; **AAA municipal**: Bloomberg Municipal AAA curve; **BBB GO munis**: U.S. General Obligation BBB Muni Yield curve. Yields are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary.

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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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