nuveen
A TIAA Company

Weekly Equities Commentary

11 Oct 2021

Delayed debt deadline brings back bulls

Last week's headlines out of Washington, D.C., provided global equity markets with a reprieve from the risk-off tone that prevailed at the end of September. Most broad-based indexes were positive for the week, notably the DJIA (+1.3%) and S&P 500 (+0.8%), while the Nasdaq (+0.1%) returned a small gain. Outside the U.S., the MSCI EAFE (+0.3%), EM (+0.9%) and ACWI ex USA (+0.7%) indexes also rebounded.

KEY POINTS

- **Interest rates continued to climb despite Friday's disappointing September employment report. This suggests that the market does not expect the report to impact the Fed's taper timeline.**
- **Though job creation has been stubbornly muted, our confidence in economic data remains high.**
- **We expect the 3Q earnings season to be challenging.**
- **Last week's measures on Capitol Hill provided some breathing room on both the debt ceiling and an infrastructure spending package. We are optimistic on both counts, but the drama is far from over.**

Saira Malik, CFA
CIO of Nuveen Equities

Saira Malik oversees the equities strategic direction for Nuveen as chair of the Equities Investment Council (EIC) and a member of Nuveen's Global Investment Committee (GIC). She has responsibility for equity portfolio management, equity research, equity trading, target date, quantitative and index strategies, as well as portfolio management responsibilities for global equity strategies.

Market drivers & risks

- **Non-farm payrolls disappointed again last Friday,** but markets were fairly stable to end the week.
  - Our two main takeaways from the sub-par but still positive report are that it (1) provides the Fed with a greater margin for error in its plans to taper asset purchases, allowing for a slower pace; and (2) may stymie what has been a rather sharp rise in interest rates. Both of these developments could be positive for equities.
- **The overhang of uncertainty around the U.S. debt ceiling was temporarily alleviated last week,** thanks to an interim agreement to push the deadline back to December 3.
  - As a result, equity markets clawed back some of their losses from the prior week. We're optimistic that this deal may boost the probability that Congress will be able to negotiate long-term deals on both the debt ceiling and the Biden administration's Build Back Better and infrastructure spending proposals. Any compromises on these fiscal priorities will ultimately result in much smaller packages. In the meantime, market volatility might remain elevated.
- **The unofficial start to earnings season begins next week,** with big banks set to report.
  - Blended earnings growth for the S&P 500 reached nearly 91% in Q2, topping initial estimates of 63%. With Q3 earnings growth estimates currently below 30%, we don't expect the same magnitude of upside surprises. Global supply chain issues added to inflationary pressures and hindered economic growth during the third quarter, and this has likely taken a toll on margins. In this environment, we continue to favor selectivity across quality growth and cyclical companies – those with strong brand recognition, innovation and scale to overcome supply chain issues. These characteristics should lead to the pricing power necessary to help defend and expand margins, especially as we enter a holiday season that is sure to be driven by strong demand.

"The next few months could remain challenging, and continued high volatility and possible near-term market selloffs are likely."

Highlights from last week

- Nine of the eleven GICS sectors posted weekly gains as investors breathed a sigh of relief after the debt ceiling deadline was extended. Energy gained more than 5% for the second straight week thanks to the effects of the Chinese energy crisis. Financials added 2.3% as the yield curve continued to steepen and the 10-year Treasury yield settled over 1.6% for the first time since June. Materials, consumer staples, utilities and industrials each added 1% or more, while health care and real estate both fell between 0.3% and 0.8%.
- Power shortages in China continue to affect global markets, as the country's scramble to secure fuel has caused the price of crude oil to top $80 per barrel for the first time since 2018. This represents a 50% surge in the global Brent benchmark and is likely to keep inflationary pressures elevated, at least through the spring of 2022.

Risks to our outlook

The agreement to delay the U.S. debt ceiling deadline may have calmed markets for now, but volatility will continue to rear its head as the December 3 deadline approaches.

Earnings season could prove to be more of a headwind for equities, as investors begin to digest the true fallout from the Delta variant surge, tax and regulatory risks from legislative plans, supply chain issues and corporate warnings.

Markets are beginning to assess the expected impacts of potential increases in the U.S. corporate tax rate and the minimum tax on U.S. companies' foreign income.

The Fed will be under intense scrutiny as it tiptoes toward contractionary policy. With markets so accustomed to quantitative easing and low rates, volatility is likely to rise as investors grow leery of a misstep in timing and/or magnitude.

Best ideas

In the U.S., reflation and expectations for higher yields could bolster returns for small caps, as well as companies with pricing power and reopening tailwinds. Supportive monetary policy and the prospect of stronger relative earnings growth will be catalysts for select stocks in cyclically oriented sectors to outperform in developed non-U.S. markets, particularly in Europe. Select growth companies well-positioned for reopening, such as front-office software leaders, also look attractive given recent weakness. We continue to advocate a long-term approach that tilts toward cyclicals and value stocks exhibiting strong earnings growth and pricing power.

In focus

Software stocks: ready to reboot

The Fed's intent to begin tapering asset purchases led to a rapid steepening of the yield curve, similar to the spike in rates we saw in the spring. This created a sense of déjà vu for technology stocks, especially in the software industry, which neared correction territory at the end of September by falling approximately 9% from their peak.

While software names may see valuations compress further as volatility rises along with interest rates, we believe there's a case to be made for structurally higher software multiples supported by growth, cash flows and risk characteristics. Specifically:

- Accelerated and widespread digital transformation is improving the pace and duration of economic growth.
- Increasingly strategic positioning with customers is making financial models more resilient.
- Supply and demand dynamics are driving plentiful access to capital.
- According to Gartner research, global IT spending is expected to reach $4.2 trillion in 2021 and grow at an annual rate of nearly 6% through 2025.

With interest rates likely to climb, we are taking a balanced approach to software with regard to duration and are recommending companies with a combination of upside risk to consensus expectations, accelerating fundamentals and attractive or defensible valuations. As rates ultimately stabilize, we believe investors will refocus on the industry's superior growth and business models.

About the Equities Investment Council:

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers, averaging three decades of investing experience. The EIC brings global expertise across different styles of equity investing and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook, including key risks and drivers, to clients. Led by Saira Malik, CIO & Head of Equities, the team shares best global equities ideas, while focusing on individual areas of expertise to help generate alpha.

For more information or to subscribe, please visit nuveen.com.

Sources

All market data from Bloomberg, Morningstar and FactSet.

nuveen

A TIAA Company

GWP-1869626PR-W1021P