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Global Investment Committee Outlook
2Q | 2019 UPDATE

Expect a tougher climb

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OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.
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Global economic growth is slowing. Monetary policy and the political backdrop are growing less certain. And volatility may rise. The rest of 2019 presents challenges, yet we believe the markets offer many opportunities. And we continue to find a variety of investment ideas for our clients.



Risk-on, but turning more defensive



Jose Minaya
Chief Investment Officer

Nuveen's 2019 Outlook, published in early December, told investors to expect a tougher climb. Since then, we've experienced a selloff in stocks and other risk assets followed by a strong recovery in the first quarter. That might have been even a tougher climb than we envisioned, but the sort of volatility and uncertainty that investors experienced over the past few months is, unfortunately, pretty typical in the late stages of economic and market cycles. And it's a reminder of why we encourage our clients to remain invested through times of volatility. Even so, we think we're in for a challenging environment for the rest of 2019.

Nuveen's Global Investment Committee (GIC) met in March to discuss key questions that drive the investment decisions we are making for our clients: What's changed since the end of last year? Does the shift in global monetary policy create more opportunities or more risks? And, most important, how are we preparing our clients' portfolios for the environment to come?

Here's where we came out: We think that while some things have changed around the margins, our macro fundamental views remain largely consistent with what we said a few months ago: Global economic growth has downshifted in the U.S., Europe and China, but we are not forecasting an imminent recession. Indeed, we think it is more likely than not that the global economy will start to recover later this year. Likewise, monetary policy has grown more accommodative. At some point, easy policy may start to cause inflation problems, but for now we think the Federal Reserve and other central banks seem to be promoting a "good enough" economic backdrop to support financial markets.

So, how are we investing in this sort of environment? Overall, Nuveen's GIC believes that we remain in a risk-on world. The economic, market and credit cycle is long in the tooth, but it isn't over quite yet. But there is an important caveat to our view: We find it highly improbable that the pace of gains we saw in the first quarter across many asset classes will persist in the coming months.

This leads us to our main investment theme we are considering across portfolios: the need to remain risk-on to meet our clients' long-term objectives, while also seeking to find more defensive opportunities. This equates to favoring reasonably priced growth in equities, different credit sectors in fixed income, tactical positioning in our alternatives strategies and other ideas you'll read about in the following sections.

Above all, we think 2019 will continue to be an environment where selectivity remains critical. For example, we generally favor equity and fixed income opportunities in emerging markets, but also believe the idiosyncratic nature of those markets means investors need to look carefully, conduct the right research and diligently scrutinize risk and reward tradeoffs — themes that hold true across all investment areas the GIC covers. And if that sounds like an argument for active management, it is. In all of our investment approaches, we think research, risk management and nimbleness will be the difference-maker this year.

A more difficult investment case

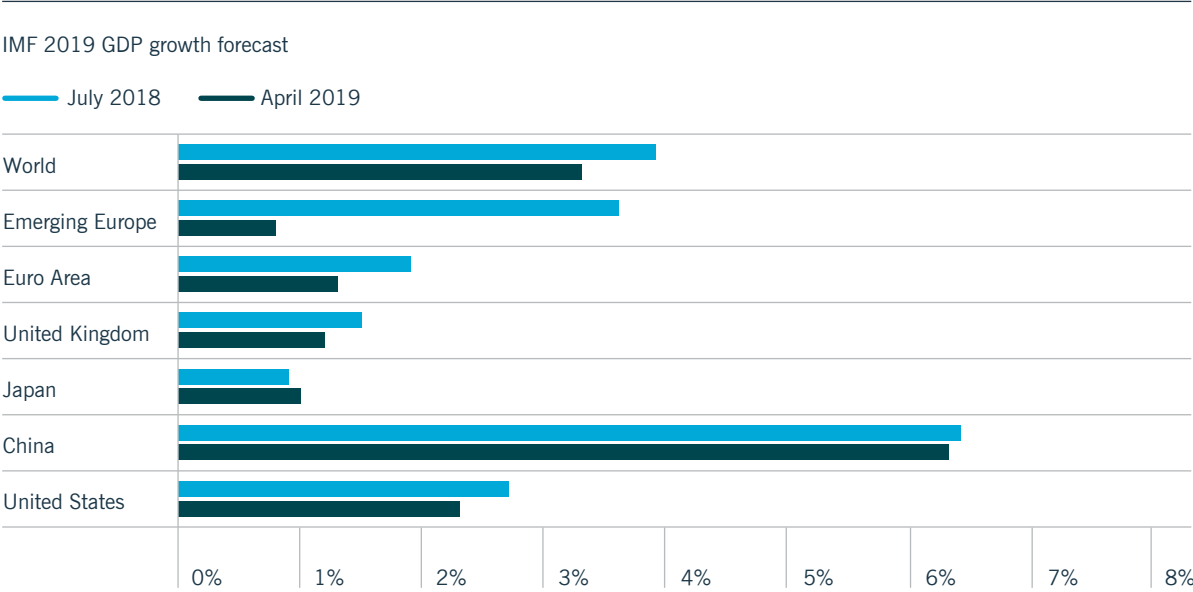


Brian Nick
Chief Investment Strategist

More questions than answers

Global economic growth will be slower in 2019 than it was in 2018. The world’s largest economies — the U.S., China and the eurozone — stalled at the end of last year, and remained sluggish in the first quarter. While decelerating growth was certainly part of the reason we expected a tougher climb for investors this year, the slowdown may be more significant than we, and other forecasters, originally expected (Figure 1). Of course, financial markets often follow their own economic forecasts, which often don’t match precisely with reality over short periods. Returns across virtually all asset classes were stronger than expected in the first quarter, but there does not appear to be a consensus view about where they may go from here.

Figure 1 – Slower than expected growth in 2019, but no collapse



Source: International Monetary Fund World Economic Outlook, July 2018 and April 2019.

In 1939, Raymond Chandler published *The Big Sleep*, a hard-boiled crime novel adapted into the 1946 film by the same name. Both the novel and the film became famous for their gripping (but at times frustrating) plots, which included multiple loose ends. Today, we’re challenged to match the crime-solving prowess of fictional private eye Philip Marlowe with our own ability to gauge the health of the world’s economy and the fate of financial markets. Is the global expansion headed for the “Big Sleep?” It will be a difficult case to solve, requiring deductive and intuitive detective work.

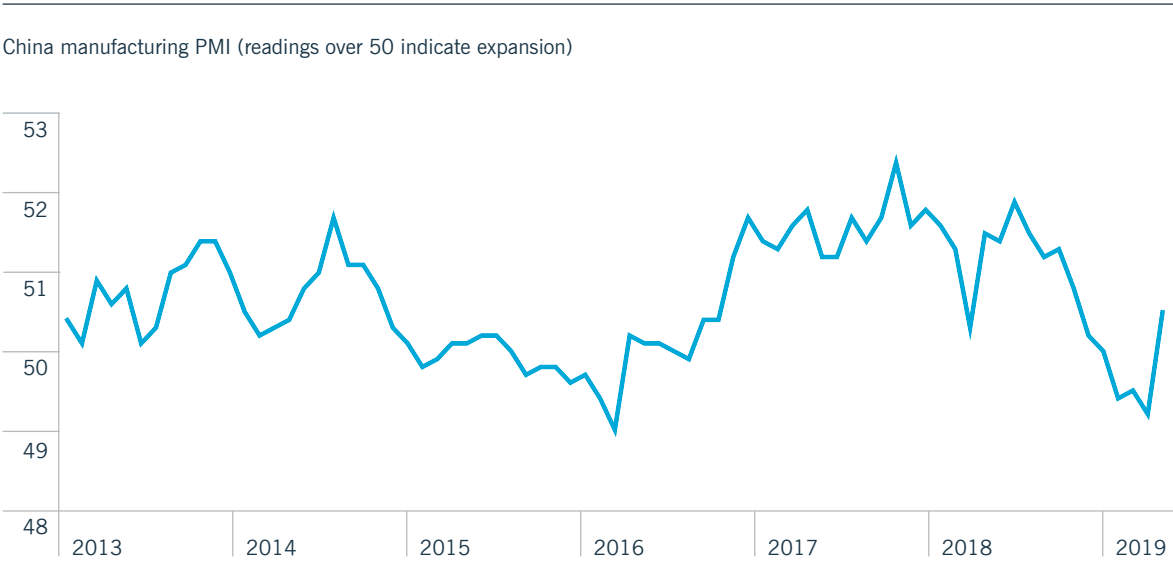
While the data is at least arriving on time in China, it’s painting a picture of slowing growth rather than recovery. China’s growth slowed by more than expected in 2018, and by all accounts that slowdown has persisted into this year. Factory output has fallen, and consumer spending and investment are merely stable, despite considerable efforts by the Chinese government to provide stimulus. We are seeing some signs of renewed growth in the Chinese economy, such as a recent pickup in manufacturing (Figure 2), but overall growth has only just begun to recover, despite months of deregulatory and tax-reducing policies.

What do the data tell us?

The logical place to start searching for clues about the global economy would be in the economic data. The trouble with this approach is that, thanks to the protracted U.S. government shutdown, most relevant U.S. data has been coming in at least one month late. And much of the data we are receiving has been warped by the shutdown itself, even if it’s difficult to tell by how much. Consumer spending and business activity were undoubtedly hit by the absence of government checks in December and January. Some of that activity was likely recouped in February and March, and will continue to bounce back in the second quarter, but we won’t know for quite some time how the first half of 2019 has shaped up.

We are late in the cycle, but we don’t see a recession in the near future.

Figure 2 – Very early signs of improved manufacturing activity in China



Source: Bloomberg. Data through 31 Mar 2019.

The situation is similar in the eurozone, where some evidence suggests the economy has bottomed and begun to recover, while other data suggest the worst is not yet over. Industrial production surged in January, but manufacturing sentiment has continued to worsen throughout the quarter, culminating with a shockingly poor reading in March. Europe may also continue to be plagued by the risk of a messy Brexit after the U.K. was granted an extension of its March 29 deadline to leave the European Union. And the continent remains susceptible to a breakdown of U.S./China trade talks, given the importance of trade to growth.

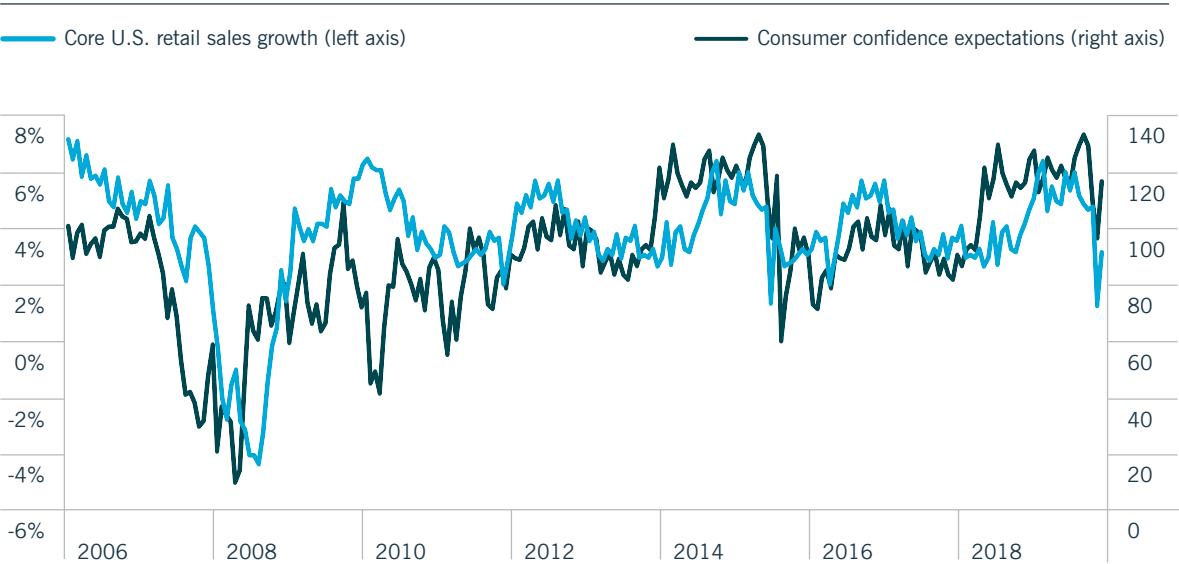
As they have for much of the past decade, U.S. consumers remain the lynchpin of any potential bounce in global growth. Retail sales growth has begun to bounce back from a horrible December, and we see more reasons for cheer in so-called “soft” data like consumer confidence. Consumer expectations for the economy have historically been correlated to spending behavior, so the recent recovery in these surveys may indicate that consumption growth can climb further (Figure 3).

The common theme running through our best ideas is becoming more defensive while staying invested.

Global central banks have flexibility to remain accommodative without causing inflation concerns.

The upshot of our analysis of recent global economic data is this: It’s going to be a tougher climb for growth in 2019, but it will be a climb higher nonetheless. The world is likely to avoid a recession or even a severe slowdown, even as GDP climbs by less than it did last year. However, given the delay in U.S. data releases and the doubts over the efficacy of China’s ongoing stimulus measures, we see an unusual amount of uncertainty around our benign outlook. And so we must look elsewhere for corroboration.

Figure 3 – As consumer expectations improve, will spending follow?



Source: Bloomberg, Conference Board, Bureau of Economic Analysis. Data through 31 Mar 2019.

What does the markets’ behavior tell us?

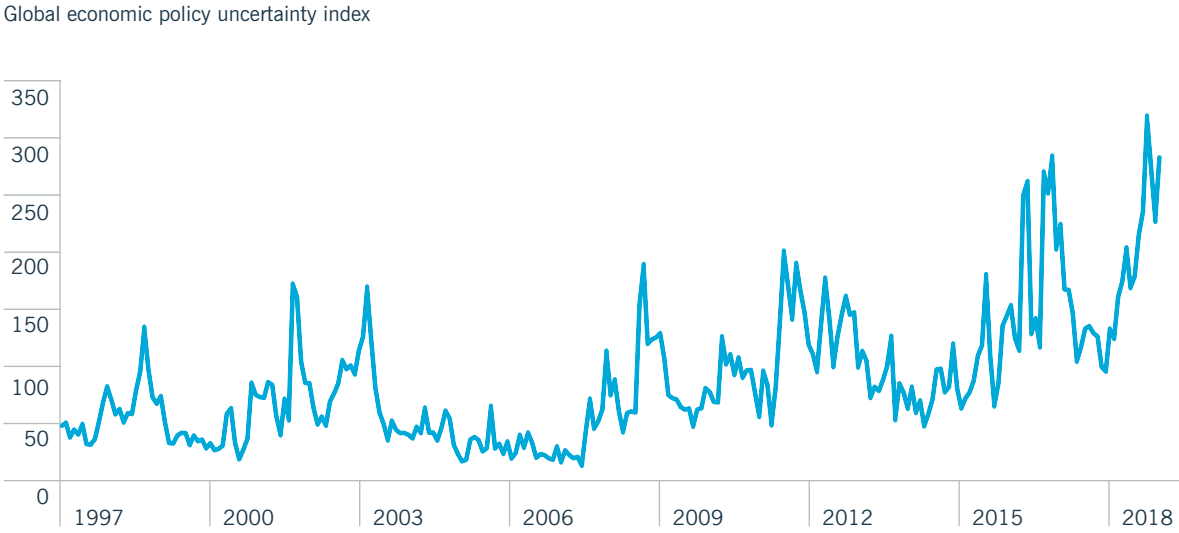
Having scoured the global landscape for clues in the economic data, we now move to another aspect of our detective story: divining meaning from the impressive first quarter rallies in both global stocks and bonds. Financial markets sounded a far louder alarm during the December panic than hard economic data actually did, and likewise exhibited a more convincing recovery in the first quarter. While most risk asset prices have yet to recover to their 2018 highs, volatility has plummeted, and recession risks are no longer priced into markets. How did this shift happen so quickly?

The growth scare and global equity market correction in late 2018 was driven in part by a spike in both the number and the severity of global policy risks. Tighter global monetary policy, escalating trade tensions and Brexit uncertainty all presented credible threats to the investment outlook. To varying extents, those risks have abated in the first quarter of 2019. Brexit and the U.S./China trade negotiations have yet to be resolved, but it seems likely (for the moment at least) that we will avoid the worst case outcomes. As a result, investors have collectively become more comfortable owning equities and corporate bonds. History and our experience suggest these assets tend to be attractive options when policy risks fall from elevated levels.¹

Historically, the only refuge for investors seeking positive returns during a period of acute event risk or recession was long-duration, high quality bonds. On the equity side, while few stocks could eke out positive returns in a bear market, defensive sectors like consumer staples and health care would likely beat technology and financials. Moreover, established commercial real estate and defensive real assets like farmland may mitigate against the forces of the public markets.

At the same time, central banks’ newly dovish rhetoric and policy choices, about which we’ll have more to say in a moment, have allowed interest rates to remain low and kept equity markets elevated by limiting the risk that rising interest rates and tighter credit conditions will prematurely end the global expansion. The net result has been a “free lunch” of sorts for global investors. Returns on both global bonds and global stocks have comfortably beaten cash, reversing the pain of last year when the opposite occurred.¹

Figure 4 – Lower policy uncertainty is helping equity markets



Source: Bloomberg, policyuncertainty.com. Data through 31 Mar 2019.

But there’s a catch. While prices have risen and risks seem to have fallen, earnings optimism has taken a hit. When economic activity slows, corporate profits growth often slows with it. That seems to be precisely what’s in store for the balance of 2019. Consensus earnings estimates for virtually all major global indexes have fallen since December.¹ This includes the U.S., where the fading effects of last year’s corporate tax cut were already set to cause S&P 500 profits growth to decelerate to single digits from over 20% last year.

Anticipating the next move

Free lunches aren’t typically offered for long. Having priced out a recession and re-rated to what we think is fair value, global equity markets are likely to now rise and fall mainly based on earnings growth. And if longer-maturity government rates remain at their current low levels — pricing out further tightening from the Fed or European Central Bank — bonds will be challenged to continue outperforming cash. We therefore cannot credibly expect investment returns to match their first quarter performance throughout the remainder of the year.

So what, if anything, do we have to look forward to? As we detailed earlier, we expect global growth to

regain its footing after a shaky start to the year. And it will be helped as global economic policy becomes more supportive of growth. Inflation data around the world — in China, but also in India, the U.S. and even Latin America — has been reliably coming in below expectations (Figure 5). This should allow global central banks to run policy hotter, without fear of stoking inflation or sending interest rates higher.

Easy money alone cannot support robust economic growth, as the post-global financial crisis period has shown. But it can help create a floor on private sector confidence and market pricing. Of course, with labor markets tight in most developed economies, keeping interest rates low invites certain risks, namely higher labor costs. If companies choose not to pass the higher costs onto consumers in the form of price inflation, they risk allowing their profit margins to erode. Indeed, according to the March National Federation of Independent Business survey of small U.S. businesses, the most pressing concern for employers is rising costs and a scarcity of available candidates to fill jobs.

Figure 5 – Negative inflation surprises provide room for stimulus



Source: Bloomberg, Citigroup. Data through 31 Mar 2019.

Investment ideas from the GIC

So what does all of this mean for our clients? Investors face a world in which asset prices have risen, while fundamentals have softened. While we expect a pickup in economic activity in the back half of this year, the evidence is still mixed, especially in China and Europe. At the same time, while easier global monetary policy has helped get us through this current rough patch, it may ultimately invite a combination of higher inflation and diminished corporate profitability.

Nuveen’s Global Investment Committee expects a smaller percentage of returns on most asset classes to come through capital appreciation (meaning a rise in the price of a security or piece of property), and a larger percentage to come through dividends, interest payments or rents. To fill the gap, each of our investment leaders has highlighted a few key areas reflecting our best ideas for adding value beyond expected market returns:

- Within **equities**, we prefer defensive growth sectors like health care and consumer staples in the U.S., while accepting more risk in emerging markets like China and Brazil.
- Having outperformed U.S. Treasuries year to date, **municipal bonds** are less attractive for their

interest rate risk, yet mispricing in select credits may provide opportunities to earn excess return.

- The significant tightening of **taxable fixed income** spreads leads us to look elsewhere for income, specifically emerging market U.S. dollar credit. We also see opportunities in structured finance.
- Farmland continues to provide attractive yields relative to local bond markets, and as such it remains our favored investment area within **private real assets**.
- We expect returns on **real estate** to be somewhat lower in most markets as the global cycle slows, but we see opportunities in European cities.

The common theme running through our best ideas is **becoming more defensive while staying invested**, reflected both in the preceding and following section from Nuveen’s Solutions team. The outlook for the global economy and financial markets is currently a puzzle with a few too many missing pieces to give us confidence about the direction from here. Unlike *The Big Sleep*, though, this case will eventually be solved once more data rolls in. But that may not happen until after the middle of this year. We continue to stay fully invested, while relying more on asset selection and less on broad market moves to generate returns for our clients.

Cross-asset views and portfolio construction from the Nuveen Solutions team

Nuveen Solutions draws upon the Nuveen Global Investment Committee’s investment outlook and asset class views to assess risk-adjusted return potential across asset classes for the next 6 to 12 months. These forward-looking views help drive positioning within diversified portfolios designed for common investor outcomes. Here, we present one of our model growth portfolios based on a 60/40 equity/fixed income allocation. For additional information on the specific models and portfolios offered by Nuveen Solutions, please visit nuveen.com.



Frank van Etten
Asset Allocation and Solutions

Asset allocation highlights for moderate growth investors

- **U.S. Equities:** Given the late stage of the cycle, we favor the defensive nature of U.S. large cap growth over the cyclicality of U.S. large cap value. We also have an unfavorable view toward U.S. small caps, as we anticipate heightened volatility and a declining U.S. dollar.
- **Non-U.S. Equities:** We previously had a less favorable view toward non-U.S. developed markets, but have moved to a more neutral position since we believe prices already reflect negative fundamentals. We continue to have a positive bias on emerging market equities, which are attractively valued and may benefit from more accommodative global monetary policy, a declining U.S. dollar and Chinese stimulus measures.
- **Aggregate Fixed Income:** While we don’t anticipate higher rates in the near term, we are less favorable on U.S. aggregate bonds given the flat U.S. Treasury yield curve.
- **Plus Sector Fixed Income:** We are positive on emerging market debt, which historically provided attractive yields and may benefit from a more stable U.S. dollar. We see less value in both high yield corporates and leveraged loans.
- **Short-Term Fixed Income:** We have a positive view toward short-term fixed income, given favorable income characteristics compared to other parts of the yield curve.

60/40 equity/fixed income growth model

Allocations (%)	Strategic	+Tactical	=Target
U.S. equity			
U.S. large cap growth	19.7	1.0	20.7
U.S. large cap value	19.3	-1.0	18.3
U.S. small cap	3.0	-1.0	2.0
Total	42.0		41.0
Non-U.S. equity			
Non-U.S. developed large cap	11.5		11.5
Non-U.S. developed small cap	2.4		2.4
Emerging markets equity	4.1	1.0	5.1
Total	18.0		19.0
Aggregate fixed income			
U.S. aggregate fixed income	30.0	-1.0	29.0
Total	30.0		29.0
Plus sector fixed income			
U.S. high yield corporates	3.0	-1.0	2.0
Leveraged loans	3.0	-1.0	2.0
Preferred securities	1.0		1.0
Emerging markets debt	3.0	2.0	5.0
Total	10.0		10.0
Short-term fixed income			
U.S. short-term fixed income	0.0	1.0	1.0
Total	0.0		1.0

Strategic allocations typically have a longer-term (5 years +) time horizon. Tactical allocation changes reflect our near term (6 to 12 months) cross-asset views.

Additional portfolio construction views

- Although not included in our growth models, we also have a favorable view toward intermediate and long municipal bonds, including high yield municipals, since they have attractive spreads and favorable supply/demand characteristics. We see little value in non-U.S. developed fixed income markets.
- We see value across real estate and private equity investments, with a particular emphasis on U.S. real estate mortgages and farmland investments.
- For income-oriented objectives, we allocate to higher quality, investment grade credit and away from more speculative grade. For potentially higher portfolio yields, we favor emerging markets debt.

Model portfolios reflect Nuveen Solutions’ investment philosophy and outlook with respect to asset allocation and individual asset classes. Nuveen Growth model portfolios (“models”) reflect exposures utilizing asset classes. These models are intended to illustrate how combinations of asset classes could be used to achieve the stated investment objectives. Results are inherently limited and do not represent actual results and may not account for the impact of the general market. The models do not consider the financial status, investment objectives, tax situation, or other needs of specific investors or client types. Providing the models does not reflect, establish or evidence an advisory or fiduciary relationship between Nuveen Solutions (NS) or a Nuveen affiliate, on the one hand, and the financial professional, his or her firm or clients, on the other. Models are not automatically rebalanced; allocations may not achieve model objectives and are not guaranteed. Model allocations may vary. Allocations are reviewed periodically and may change based on NS strategic and tactical views. There are no management or other fees at the model level; however fees apply for the underlying investment products. The models’ risks are directly related to those of the underlying asset classes, as described below. Allocations may not match a client’s actual experience from an account managed in accordance with the model portfolio allocation. Objective and goals may not be met.

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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. Quarterly meetings of the GIC lead to creation of published outlooks that offer 1) macro and asset-class views where there is consensus among our investors 2) insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.) 3) guidance on how to turn our insights into action via model portfolio commentary from Nuveen's Solutions, CIO and team.

For more information, please visit nuveen.com

Endnotes

Source: ¹ Market and economic data from Bloomberg.

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A word on risk

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. Foreign investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings. 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. Socially Responsible Investments are subject to Social Criteria Risk, namely the risk that because social criteria excludes securities of certain issuers for non-financial reasons, investors may forgo some market opportunities available to those that don't use these criteria. Investors should be aware that alternative investments including private equity and private debt 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. Alternative investments may be illiquid, there may be no liquid secondary market or ready purchasers for such securities, they may not be required to provide periodic pricing or valuation information to investors, there may be delays in distributing tax information to investors, they are not subject to the same regulatory requirements as other types of pooled investment vehicles, and they may be subject to high fees and expenses, which will reduce profits. Alternative investments are not suitable for all investors and should not constitute an entire investment program. Investors may lose all or substantially all of the capital invested. The historical returns achieved by alternative asset vehicles is not a prediction of future performance or a guarantee of future results, and there can be no assurance that comparable returns will be achieved by any strategy.

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