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Global Investment Committee Outlook
4Q | 2019 UPDATE

Expect a tougher climb

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Risks seem to be rising. Investors are confronted with uneven economic growth, the increase of negative interest rates around the world and rising geopolitical uncertainty. We're calling for a tougher climb when it comes to investing from here, but we are continuing to find multiple investment ideas for our clients.

Play defense, but stay in the game

Jose Minaya
President and Chief Investment Officer

Late last year, Nuveen's Global Investment Committee's 2019 Outlook told investors to *Expect a tougher climb.* For the first few months of this year, that scenario didn't really play out, as risk assets rebounded strongly from the late-2018 selloff. But since then we've started seeing cracks in the system: uneven and slowing economic growth, rising trade tensions, broader political uncertainty, higher volatility and falling and even negative interest rates. These changes have of course complicated life for investors of all stripes — and they also fed into a lively discussion at our GIC meeting in September.

In many ways, most of these risks aren't really new: We have been worrying about the pace of economic growth since pretty much the end of the global financial crisis, and since that time we've experienced market corrections and interest rate volatility.

But in other ways, these risks are starting to feel more acute. The rates environment in particular seems troubling, and it's a topic we (rightfully) devoted quite a bit of time to at our recent meeting. The shifting rate environment affects everything from portfolio positioning for our equity, fixed income and alternatives portfolios to how we price private market deals. And, for sure, lower and negative rates make it tougher for our clients to find the yields they need to maintain income levels or fund their liabilities. At the same time, we're getting the sense that political risks are growing. We're starting to see trade-related problems work their way into the economic data for the worse. And that's without even considering growing tensions in the Middle East or the messy Brexit situation.

So what does all of this mean for our investment outlook and — more important — investment positioning? Our main macro takeaway from our meeting is that we think economic growth will remain troubled, but we don't see a recession over the next year. Related, we think interest rates will remain depressed for some time. And that means investors should probably expect lower returns across asset classes than they enjoyed over the last few years: There's that tougher climb.

That's why we are continuing with our view that it makes sense to stick with more defensive positioning across asset classes. As we said in our midyear outlook, that means things like focusing on quality defensive growth stocks, seeking more resilient yield opportunities in fixed income and looking for yield and diversification benefits throughout real assets, real estate and other alternatives. But turning more defensive is not the same thing as adopting a risk-off stance, and all of our asset class leaders and portfolio managers remain committed to being fully invested and to finding opportunities to help our clients meet their financial goals.

If one consistent investment theme clearly emerged in our last Global Investment Committee meeting, it was that selectivity matters more than ever. We broadly agree that we're approaching the end of a very long economic and market cycle, which means the easy money has already been made. From here, investors must remain nimble, look for tactical opportunities to capitalize on volatility and construct portfolios with increasing care.

Still climbing, but the terrain grows rockier

Brian Nick
Chief Investment Strategist

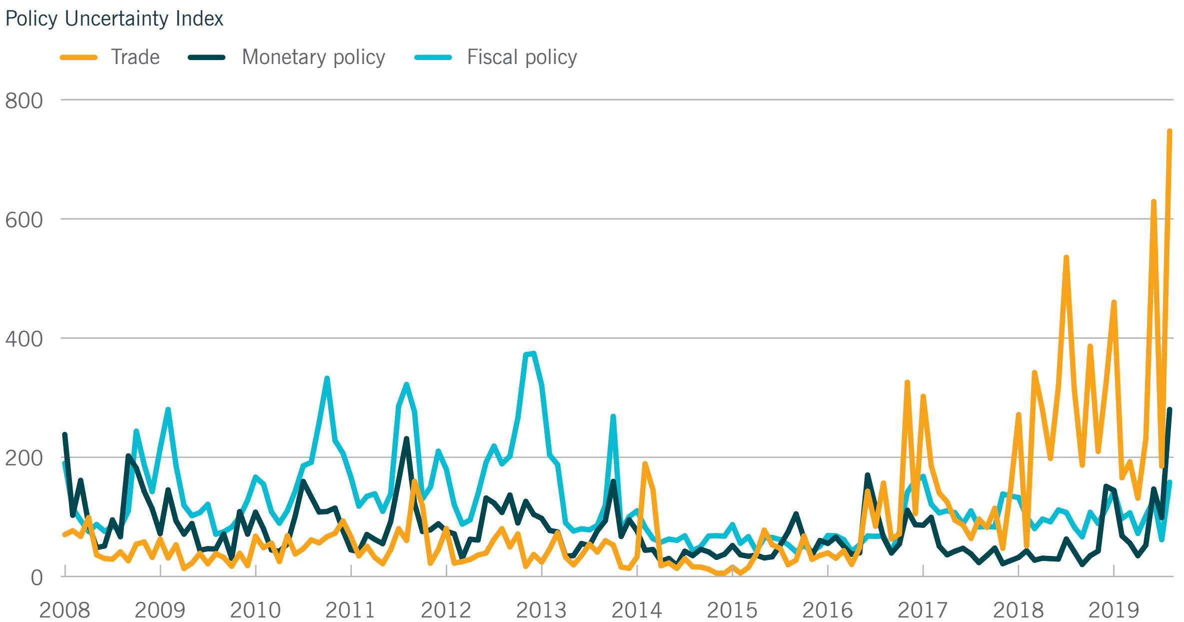
- The global economy is facing increasing downward pressure, although we agree with the consensus that a recession isn't quite yet in the cards.
- Lower (and in some cases negative) interest rates are complicating the investment outlook. Rates may still be too low, but we are not expecting a sharp climb.
- While we continue to favor more defensive positioning among and within most asset classes, we are still finding investment opportunities.

More money, more problems

The third quarter was marked by the continued slowing of global economic growth, sprinkled with a healthy dose of policy uncertainty. Nevertheless, most major asset classes were able to build on the solid gains they made in the first half of the year. Unlike the market swoons of 2015 and 2018, the August volatility was driven by a sharp drop in global interest rates, not by panicked equity investors. Indeed, the prevalence of negative interest rates in global bond markets, resulting from lackluster growth and dovish central banks, became a source of concern in its own right as observers justifiably pondered the longer-term implications.

Around the world, policy uncertainty — dominated by trade risks (Figure 1) — is dampening risk appetite and contributing to choppier market conditions. It may even be turning some recession indicators from yellow to red, especially those tied to global manufacturing. Yet while we continue to expect the slower global economy to be a headwind for investors, we are not expecting a U.S. recession or a further abrupt slowing of growth in other major economies.

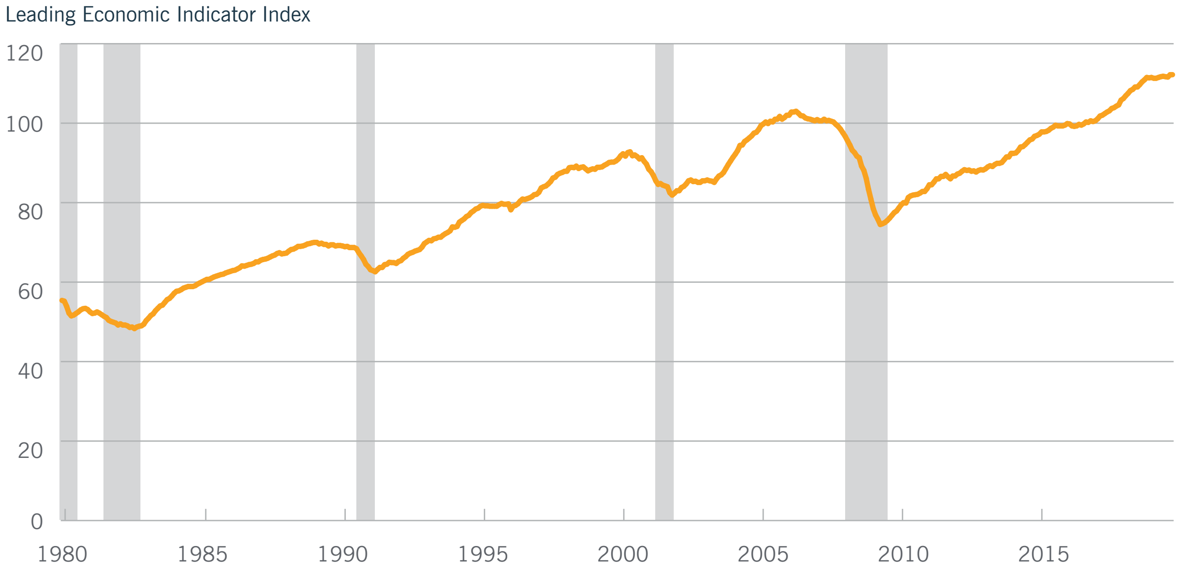
Figure 1 – Trade is by far the largest source of uncertainty



Source: Bloomberg and policyuncertainty.com. Data from Jan 2008 to Aug 2019. The Policy Uncertainty Index measures policy-related uncertainty via an analysis of media coverage, tax code provisions and disagreement among economic forecasts.

Although recession risks are rising, ***we don't see one materializing over the next year.***

Figure 2 – U.S. leading indicators continue to point to growth



Source: Bloomberg, Conference Board. Data from Jan 1980 to Aug 2019. Shaded areas indicate recessions. The Leading Economic Indicator Index is intended to predict future economic activity.

The global economy is slowing, but not in recession

Indeed, there was broad consensus at the Nuveen Global Investment Committee meeting in September that the global economy has slowed further and may continue to do so over the coming months. Factory output, as estimated by the Global Manufacturing Purchasing Managers Index, is contracting. But in a sign of what qualifies as good news these days, the pace of contraction no longer appears to be accelerating. Even so, manufacturing activity remains weak in China and the eurozone, which have been among the world's most disappointing growth stories to date. Europe's consumers are driving growth, while manufacturers continue to struggle. The lack of investment in the U.K. due to Brexit-related uncertainty would be more concerning in the absence of low unemployment and solid retail sales growth.

In the U.S., few professional forecasters are calling for a recession in the next several quarters, but the broad consensus seems to be that we should be increasingly worried about one materializing. We agree that recession risks have risen in recent months. The U.S. Treasury yield curve is inverted at key intervals that have accurately predicted recessions in the past, and manufacturing is slowing. But most economic and market indicators we use to project U.S. recessions are still in "safe" territory: Consumers are optimistic about the future, builders are applying for permits and unemployment claims are near a 50-year low. Finally, despite third quarter volatility, financial market conditions have remained generally loose. With all of these positive data points, the Conference Board's Leading Economic Indicators Index resumed its climb over the summer (Figure 2).

If we are wrong, it will probably be because the U.S. consumer falters unexpectedly despite the recent uptick in wage growth and personal savings rates. What could cause such a reversal? A further increase in tariffs on consumer goods coming from China or elsewhere is one possibility. A prolonged military conflict in the Middle East that disrupts the global market for oil could also be a factor. Or, we could see a policy shock outside the U.S., such as a messy "no deal" Brexit, prompting recessions across Europe.

I'd gladly pay you Tuesday for a German bund in 2029

Wimpy, the hapless character from the old Popeye cartoons who routinely offers to pay people "on Tuesday for a hamburger today," would have thrived in today's interest rate environment in which money can be worth more in the future than it is in the present. At various points during the third quarter, nearly one-third of all investment grade bonds around the world were trading with negative interest rates. That means a significant percentage of global investors were willing to pay high enough prices to guarantee losses on sovereign and corporate debt if held to maturity. That's a pretty shocking concept if you step back and think about it.

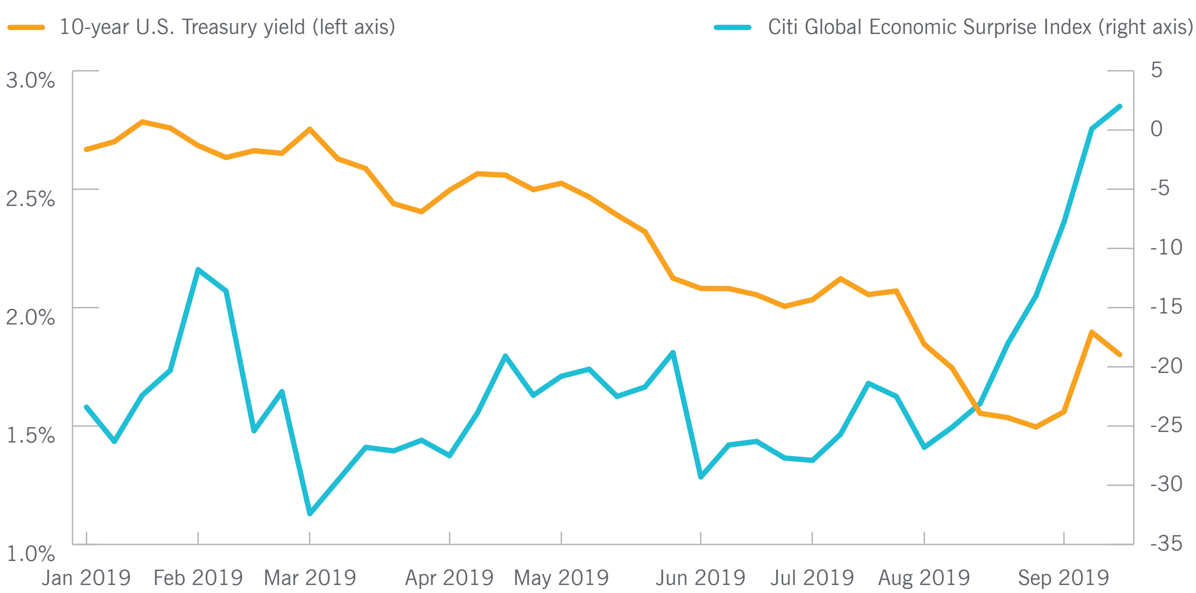
So what explains the prevalence of negative interest rates? Disappointing data and diminished expectations about future growth have played a big role. As global growth surprises — the quality of data releases relative to consensus forecasts — stayed negative for most of 2019, interest rates on U.S. Treasuries and their closest counterparts plummeted. In September, however, positive surprises and negative surprises began to occur in roughly equal measure, coinciding with a mini-surge in rates around the world (Figure 3).

Global central banks are also helping to keep rates low, especially at the short end, thanks to interest rate cuts from the Federal Reserve, the European Central Bank and other central banks. When central banks load up their balance sheets with high quality bonds, there are fewer left for other investors at a time when the premium on safety has risen sharply. This inadequate supply of government bonds relative to demand — even allowing for the roughly $1 trillion in new U.S. Treasury issuance over the past year — is predictably leading to higher prices and thus lower yields.

Ultra-low interest rates *may make stocks look relatively more attractive.*

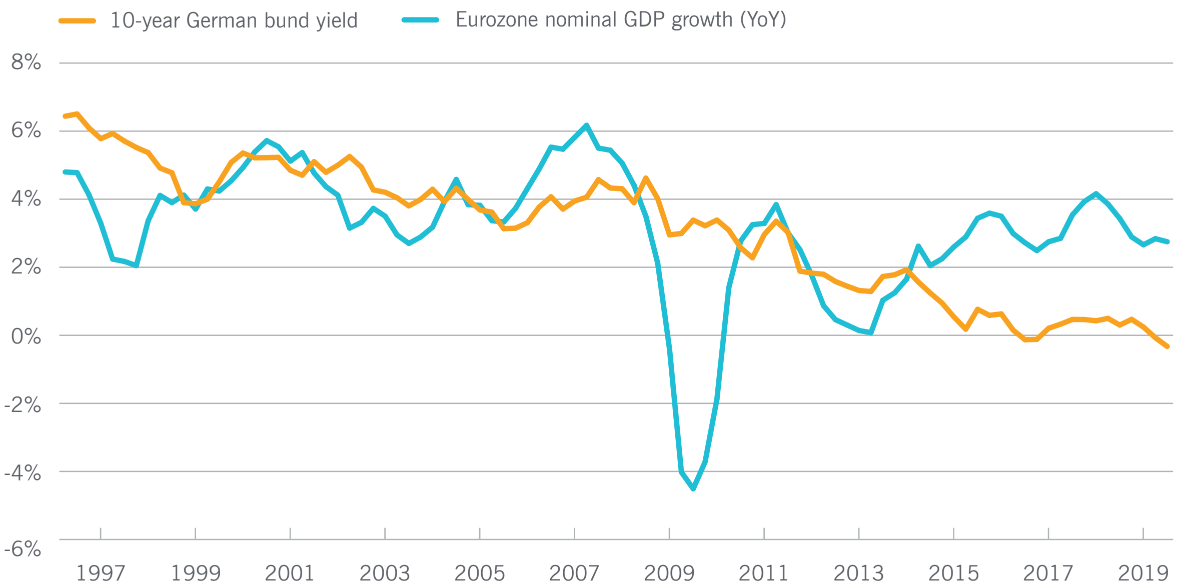
Our GIC spent a good deal of its September meeting talking about how to value risk-return tradeoffs on investments ranging from property deals to corporate bonds in an environment in which the risk-free rate is negative. Banks' operating models certainly come under stress when interest rates fall below zero or when short-term rates are high relative to longer-term ones. That can depress credit creation and short circuit self-sustaining economic growth.

Figure 3 – Negative rates are a byproduct of disappointing economic data



Source: Bloomberg, Markit. Data from Jan 2019 to Sep 2019. The Citi Global Economic Surprise Index measures whether economic data have been beating consensus estimates.

Figure 4 – Are interest rates too low? Probably.



Source: Bloomberg. Data from Mar 1996 to Jun 2019.

Over time, interest rates on longer-term bonds should roughly correspond to the level of expected nominal GDP growth (inflation + real growth) over the term of the bond. Lately, that relationship has broken down in the eurozone and elsewhere (Figure 4). We think rates probably fell too far in the third quarter, but negative yields may be here to stay in at least some corners of the world — notably, Japan and Germany — which should keep demand strong for the 10-year U.S. Treasury. If and when interest rates do rise meaningfully, it will mean investors have become more willing to take risks based on an improving outlook.

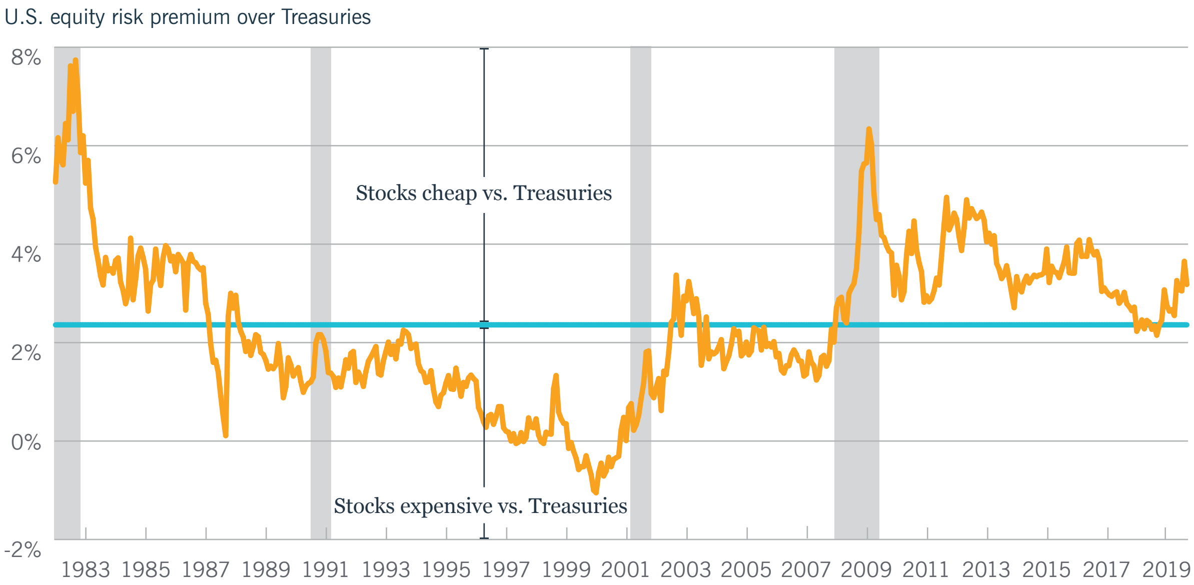
Similarly, we would welcome a world in which major central banks no longer need to cut interest rates or buy bonds in the open market to instill confidence in the economy. That said, we view the ECB's open-ended commitment to grow its balance sheet as a helpful policy measure since it will be hard to reverse absent substantial improvements in the eurozone economy. In the U.S., the Fed may slow or pause its interest rate cutting campaign as we head into 2020. The more extreme easing scenario priced into futures markets will only come about if growth meaningfully disappoints from here.

Invest in climbing gear, but wear a parachute

Nuveen's Global Investment Committee represents a wide range of asset classes and investment strategies. But today portfolio managers are virtually unanimous in moving into a more defensive posture to prepare for slow global growth and to help minimize the effects of a sharper slowdown or recession. Our expectations for publicly traded asset classes — stocks and bonds — are low compared to what they've delivered in the past several years, including gains made so far in 2019.

Even so, we cannot ignore the relatively wide value stocks offer today compared to the "risk-free" rates of return on cash or longer-term government bonds (Figure 5). This spread is not wide on account of stocks being cheap, but because interest rates on many bonds are close to their all-time lows and the cash rate continues to decline as the Fed eases.

Figure 5 – Ultra-low rates are making stocks more attractive



Source: Bloomberg, Nuveen, Robert Shiller. Data from Jan 1982 to Sep 2019. Shaded areas indicate recession. Equity risk premium refers to the excess return investing in stocks has provided over a "risk-free rate" such as Treasuries. As Treasury rates fall, that premium tends to grow.

Investment ideas: What's changed? Trade tension has risen, rates have fallen

As we look to exploit mispricings in our respective markets while being cautious about the macroeconomic and geopolitical backdrop, our investment leaders offer up their key areas of focus:

- We prefer **higher quality assets in taxable fixed income** given the narrowing in credit spreads; emerging markets U.S.-denominated credit is still attractive compared to other markets, and we want to diversify out of more interest rate-sensitive sectors while avoiding excess risk in U.S. high yield corporate debt.
- **Municipal bonds are benefiting from historically strong investor demand,** including from overseas investors who value yield despite being ineligible for the tax benefits; the municipal yield curve remains upward sloping and rates are strongly positive, one reason we remain overweight both duration and credit risk.
- **Real estate is an area where flexibility and selectivity is key.** Our strategy for assessing private real estate properties has turned more defensive, given that we expect most returns to come from lease payments and not capital appreciation for the time being; in publicly listed real assets, we are reducing exposure to cyclical risk and favoring secular growth areas like data centers and other infrastructure.
- Within equities, **we continue to target U.S. growth stocks with a defensive tilt when the price is right;** we are becoming more selective within emerging markets, especially Brazil, given expectations of higher foreign investment demand and incidental benefits from the U.S./China trade war.

We haven't made sweeping changes to our investment outlook or strategies so far in 2019, despite significant price action and occasional bouts of volatility. The unexpected escalation in the trade war over the summer may prove fleeting — the U.S. and China may already be getting back to the negotiating table — but global firms have been economically damaged by increased operating costs and forgone investment. We don't see a strong acceleration in the global economic cycle on the horizon and are therefore satisfied to invest somewhat more defensively than we were a year or two ago. Low interest rates are forcing all investors — including us — to contemplate what a reasonable rate of return will look like in the 2020s. As we have been saying all year, however, the climb is getting tougher.

Portfolio construction views

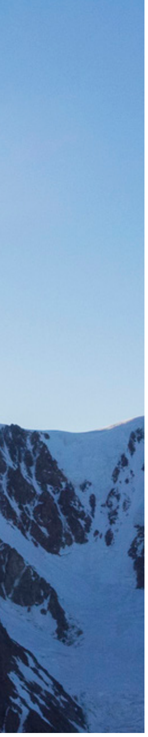
Together, Nuveen's Global Investment Committee and Solutions Team construct asset class views that assess risk-adjusted return potential for the next six to 12 months. These forward-looking views help drive positioning within diversified portfolios designed for common investor outcomes. Here, we discuss asset allocation views for a long-term growth investor and address how these views might shift in different market environments.

Jose Minaya
President and Chief Investment Officer

Frank van Etten
Asset Allocation and Solutions

Asset allocation highlights

- **We are broadly neutral toward equities**. For investors who are looking to put money to work, **we favor the more defensive characteristics of U.S. large cap growth**, as we expect uneven economic growth and weakening corporate earnings. As a rebalancing possibility, we are less bearish toward U.S. large cap value (as relative valuations have become more attractive) and toward non-U.S. developed markets (earnings prospects now look aligned with emerging markets). We downgraded small caps based on their more cyclical nature, weaker earnings momentum and balance sheets and less ability to handle trade-related supply chain disruptions.
- Given our interest rate views and the benefits of broad diversification within fixed income, **we are more comfortable with duration risk** and think investors could take on more exposure to aggregate fixed income (**we still remain more bullish toward short-term fixed** income due to a flatter yield curve). Given our preference for higher credit quality, **we prefer allocations to investment grade corporates over other credit sectors and believe securitized assets look attractive for their income and diversification potential**. After a very strong run, preferred securities now look broadly expensive and represent an opportunity to take profits, but we continue to see select opportunities. And given strong fundamentals, **we're seeing strength within municipals given the relative yield advantage over Treasuries with a bias toward high yield**. We are upgrading non-U.S. developed fixed income, favoring the longer duration of those markets with a preference for higher quality.
- Within alternatives, real estate valuations have gotten more full, but we'd highlight income potential and we favor debt investments in the private real estate space. We're seeing select opportunities across other areas, but **manager selection remains critically important for alternatives, particularly in the latter stages of the economic cycle.**



	❮ Negative		Neutral		Positive ❯
Equity					
U.S. Equity			○		
Large cap growth				●	
Large cap value			○		
Small cap		●			
Non-U.S. equity					
Developed			○		
Emerging markets			○		
U.S. fixed income					
Short-term					●
Aggregate fixed				●	
Inflation-linked (TIPS)			○		
Investment grade corporates				●	
High yield corporates		●			
Senior loans		●			
Preferred securities		●			
Securitized assets				●	
Investment grade municipals			○		
High yield municipals				●	
Non-U.S. fixed income					
Developed		●			
Emerging markets				●	
Alternatives					
U.S. REITs			○		
Private real estate			○		
Middle-market loans			○		
U.S. farmland			○		

Downgrade from last quarter *Upgrade from last quarter*

The views above are for informational purposes only and reflect six to 12 month views across asset classes. These do not necessarily reflect a portfolio or the experience of any Nuveen product or service.

Asset allocation views for different scenarios

The preceding are based on the views expressed in our fourth quarter outlook. But what if we are wrong?

- **The more bearish case:** We are already advocating a mostly defensive stance, but what if conditions worsen and we see economic stagnation, higher inflation and an inverted yield curve? In such an environment, we would suggest increasing allocations to highly liquid, short-term fixed income investments (cash equivalents). Lower yields would make longer-dated Treasuries even more attractive, and municipals and defensive areas of the real estate market would likely benefit. We would also suggest increased focus on defensive equity strategies, particularly those with healthy dividends.
- **The more bullish case:** This scenario is further from our base case, but what if we see a surprising trade war resolution and/or a rebound in global manufacturing sparking a reacceleration in economic and earnings growth as well as higher rates? Should this happen, we'd sharply reverse many of our base case positions: Lower quality and lower duration would likely win out in fixed income; cyclicals, value and small caps would be better plays in equities and less defensive alternatives would look more attractive.

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 commentary from Nuveen's Solutions, CIO and team.

For more information, please visit nuveen.com

Endnotes

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

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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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