Coronavirus, rate cuts and long-term portfolio positioning

As financial markets whipsawed in the wake of the spread of the coronavirus, Nuveen’s Global Investment Committee (GIC) met on 2 March to talk about the ongoing volatility, how investors should position their portfolios and the longer-term opportunities we would recommend to our clients to help them reach their goals. The next morning, the Federal Reserve surprised with a 50 basis point rate cut. In advance of our GIC 2Q Outlook due out in a few weeks, we offer the following updates from our discussion.

Insights from Nuveen’s Global Investment Committee

ONGOING MARKET VOLATILITY: THREE THEMES FOR INVESTORS TO CONSIDER

Theme 1: Be humble amid uncertainty

- We are already seeing global economic and market effects from the coronavirus that will rival (if not exceed) the disruption from the U.S./China trade war. It’s too early to accurately gauge the full effects.
- The primary source of uncertainty in our outlook is whether the virus spreads widely enough to trigger a genuine demand shock in the U.S. and Europe, meaning a pause in consumer spending and business operations.
- Our base case remains a steep dip in global growth in the first half of the year followed by a recovery starting in the third quarter, but we cannot be confident about a) the size of the dip and b) the timing of the recovery. So we caution our clients against trying to time tactical investments.
- In other words, we think the recovery, when it comes, will be relatively quick and sharp. We don’t advise trying to time an economic or market bottom.

Theme 2: Stick to your script

- This is the flip side of our first theme: This is not a time to panic or move to cash. Doing so defeats the purpose of long-term investment planning and strategies such as regular rebalancing and dollar-cost averaging.
- None of our GIC members expressed plans to shift to an even more defensive stance in their investment strategies, nor do we advise our clients to do so. We continue to advocate that investors rebalance as part of their routine portfolio maintenance, which at the moment may mean selling safe havens that have expanded to command a larger portion of a portfolio to buy riskier assets like equities. In other words, if an
investor was already planning to invest in equities or other risk assets, we see no reason to deviate from that strategy.

- About equities: Thanks to the coronavirus-inspired correction, stocks now look cheap compared to bonds – but only if you believe earnings growth won’t fall sharply this year. Rather than search for the market bottom, our approach during this market turmoil has been to rebalance into “quality value” sectors like industrials and semi-conductors. We also believe that companies with stable growth, healthy balance sheets and well-covered dividends should find support in this ultra-low rate environment.

- For investors with income needs who can stomach some additional near-term volatility and selloffs, we are comfortable taking on more risk in fixed income credit markets given the selloff – including in less-favored sectors like U.S. high yield credit.

**Theme 3: Diversify, including your time horizon**

- Even before the coronavirus, we had been cautioning investors that market returns would be lower over the medium to long term (i.e., the 2020s) than they were in the 2010s, which may call for rethinking an overall approach to building portfolios.

- In our view, most investors we speak with are under-diversified, especially when it comes to fixed income areas such as emerging markets debt and allocations to alternatives, including real estate and real assets.

- Within real estate, we continue to have an overall defensive positioning, avoiding the retail and office sectors in favor of properties in areas such as senior living, health care and biotechnology. Our public and private real assets holdings are likewise defensively tilted and are benefiting from lower interest rates. We are also finding good opportunities here in themes associated with responsible investing, such as renewable energy.

- Diversification goes beyond asset classes: We think many investors would benefit from also diversifying their time horizons.

- The attractiveness of less-liquid private assets can be enhanced during market turmoil by virtue of the fact that they are not marked-to-market on a daily basis. (Consider, for example, that many private equity investments “missed” much of the severe but brief late-2018 correction).

**THE FED RATE CUT MEANS WE SHOULD EXPECT RATES AND YIELDS TO BE LOWER FOR LONGER**

The Federal Reserve surprised markets on Tuesday morning with a rate cut, moving the fed funds target rate range to between 1.00% and 1.25%. While the central bank maintained that “the fundamentals of the U.S. economy remain strong,” it also acknowledged that the coronavirus presents “evolving” risks to its outlook.

The Fed had been widely expected to reduce rates at its 18 March meeting in anticipation of economic weakness from the effects of the coronavirus, but felt it needed to act sooner to assuage market concerns. The 10-year U.S. Treasury yield had fallen from 1.92% to start the year and is of this writing flirting with an historic low of 1%.

So far there is little evidence in economic surveys or data that the U.S. economy is suffering as a result of the global spread of the coronavirus and the production stoppages it has caused in China. But global manufacturing sentiment plummeted in February, and financial markets are anticipating that it will soon have a wider effect on the U.S. and the world.

While monetary policy can help ensure that markets function properly and liquidity remains ample, this tool is too blunt to be deployed effectively against the health crisis related to the coronavirus and its ripple effects into the broader economy. We have yet to see a credible policy response – in either the U.S. or coordinated globally – to the specific types of
shocks that could occur should the virus’ impact widen from here. This is one reason we remain cautious about trying to time the bottom for equity or credit markets at this stage.

Now that the Fed has opened the door to cutting rates to combat anticipated economic weakness from the coronavirus, we feel it may have little reason to stop anytime soon. Markets remain skittish about headline risk, and the negative U.S. economic data have not even begun to arrive. While we believe that a V-shaped pattern is likely for both the equity market and global economy this year – that is, a steep decline followed by a sharp trajectory upward – we have far less conviction that interest rates will rise significantly in any recovery given the Fed’s increasing comfort with lower rates. This means that our views here about seeking diversification are going to be even more relevant for investors trying to generate income to meet their liabilities or spending needs.

For more information, please visit us at nuveen.com.

Endnotes
Sources
Bloomberg.

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