Market stability improves, but portfolio questions remain

At this point, it appears the worst of the panic selling across global financial markets may be behind us. Thanks in large part to widespread stimulus measures, market liquidity has been returning, but investors remain unsure of how to structure and rebalance their portfolios. Nuveen's Global Investment Committee provides some perspective on the key questions we're hearing from our clients.

Insights from

Nuveen's Global Investment Committee

HAVE WE SEEN SUFFICIENT FISCAL AND MONETARY STIMULUS TO STEM THE CRISIS?

The answer depends on how you define the crisis. From a financial markets perspective, we started to see volatility levels decline and liquidity improve over the past week. Markets have clearly been responding positively to global stimulus measures and central bank policies.

Two weeks ago, areas such as short-term credit markets and municipal bond markets were effectively broken, but the subsequent fiscal stimulus and aggressive intervention by central banks have helped markets to act relatively more normally. We think volatility is likely to remain elevated for some time, but financial markets seem to be emerging from emergency crisis mode.

The bigger question, however, is whether or not stimulus measures will solve the economic crisis. Unfortunately, the likely answer is that stimulus will help, but we're still in for a rough economic ride.

The focus right now is on the $2 trillion package enacted by the U.S. federal government. Direct payments to individuals will help with near-term spending needs, and direct assistance to state and local governments as well as targeted industries will help stave off some immediate pressures. But we do not yet know whether the stimulus will keep businesses afloat or prevent further widespread layoffs.

We'll be watching several signs to gauge the effectiveness of the stimulus measures, which can also help determine whether more are needed. Positive signals would include limited jobless claims and payroll losses along with contained bankruptcies and defaults. Other data such as consumer spending levels will be less useful since spending is being intentionally suppressed.

Comparisons between the U.S. and European economies will be instructive: The U.S. extended unemployment benefits, while the United Kingdom and several other European countries opted for payroll subsidies, so we may have a real-time test case to see which approach is more effective.

WHAT IS THE OUTLOOK FOR THE GLOBAL ECONOMY?

In most parts of the world, a sharp and deep economic recession began in the middle of March. The second quarter is going to be abysmal for the global economy. But in some ways, the worse it gets in the second quarter, the better off the world may be in the long run because it will show that governments, businesses and individuals are serious about changing their behavior to contain COVID-19 quickly.

Success at containing the virus will determine whether or not we see economic growth recover strongly in the third quarter. Evidence from China and elsewhere in Asia is mixed as some parts of those economies are starting to open. Still, pressures to suppress economic activity around the world remain intense, making it difficult to forecast future economic growth. Real-time data such as the number of new COVID-19 cases and initial jobless claims will be useful barometers. Corporate earnings, tax revenues and most economic data are important, as well, but they will only become available with a long lag. Even this Friday's March U.S. employment won't tell us that much, because the data were collected before extreme mitigation strategies were enacted.

SHOULD INVESTORS CONTINUE (OR START) TO REBALANCE PORTFOLIOS?

This is a timely question, since we are now at quarter end and many investors use this time to rebalance. Additionally, many institutional investors use a 5% deviation from targets as a trigger to rebalance, and it's hard to imagine that there are many investors who didn't hit such a trigger since the start of the year. A rebalancing strategy should be an integral part of every long-term plan or Investment Policy Statement, and we think investors should stick to their plans and continue to rebalance, provided they have the near-term liquidity they need to meet spending and liability needs.

Drilling down to a few specific rebalancing questions, we would include some additional considerations. First is liquidity. Two weeks ago, there were concerns that market liquidity might not be sufficient to rebalance, but we don't think that is the case today. We are, however, seeing some investors rebalance in stages rather than all at once, which makes sense. Second, in addition to changes in valuations between asset classes, we have also seen changes between relative risk expectations. We think both factors need to be considered when constructing and rebalancing portfolios. And third, for those investors who are invested in long-term illiquid investments, it is important to remember those are priced with a lag, so using public market proxies can help determine current values.

ARE THERE OPPORTUNITIES FOR THOSE LOOKING TO PUT CASH TO WORK?

From a long-term perspective, our investment teams are continuing to position portfolios defensively, and that's a strategy we think makes sense for most investors. Within public equities for example, we are generally favoring growth over value since growth provides defensive exposures via lower leverage and less cyclical connection to the economy. Likewise, we think large caps are better positioned than small caps for now because of better earnings sustainability and better balance-sheet strength.

In fixed income markets, we currently prefer higher credit qualities and favor emerging markets debt over areas such as U.S. high yield given the former will likely benefit from a depreciating dollar and the latter has a high exposure to energy prices. Municipal bonds should also benefit from strong fundamentals and stimulus-related assistance.

Additionally, we remain focused on defensive areas of the public and private real assets—like farmland—and real estate markets. We also think it makes sense to continue looking at less liquid private equity and credit markets that can provide buffers during price shocks.

At the same time, we have been seeing value created across and within financial markets, especially in areas that have been hard hit in equities, credit markets and municipals. For those investors with very long time horizons and, more importantly, very high short-term risk tolerances, it could make sense to make heavier moves into cyclical stocks or lower-quality credit at the expense of government bonds. Making any of these moves, however, requires extreme case, diligent research and a high degree of selectivity.

WHAT SIGNALS SHOULD WE BE WATCHING TO DETERMINE WHEN THE CRISIS MIGHT BE BOTTOMING?

As we indicated earlier, we expect volatility to persist and we don't think it would be appropriate to make guesses about where market prices will bottom, but there are factors we are watching.

The most important sign would be a plateau in new COVID-19 cases in the world's largest developed economies. Once that happens, we will be better able to assess the related supply and demand shocks and provide more clarity on the corporate earnings outlook. Related, we're watching the economic data from countries that have had more success containing the virus, with particular focus on signs of stability emerging from China.

We also expect more fiscal stimulus. As of now, about 20 countries have enacted fiscal stimulus measures with most aimed at providing support for health care systems as well for individuals and businesses most immediately affected by the crisis. We are looking for additional measures over the coming weeks and months.

From a technical markets perspective, we're also looking for market volatility to continue receding, credit spreads to narrow further and market correlations between different asset classes to fall. All of these factors would be signs that financial conditions are improving, likely leading to better economic outcomes.

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

Endnotes

Sources

Bloomberg.

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