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Weekly Fixed Income Commentary

22 June 2020

Risk-averse market tone proves pervasive

U.S. Treasury yields ended the week modestly lower, led by longer maturities.[1] Markets appeared focused on escalating coronavirus concerns, despite generally stronger U.S. economic data. Rising U.S. virus cases are stoking fears of another lock down and associated slowing in economic activity.

HIGHLIGHTS

- **The securitized sectors outperformed other non-Treasury, taxable U.S. sectors.**
- **The municipal market was range bound, although high yield municipals continue to recover.**
- **The global aggregate index delivered a modestly positive total return, helped by positive returns in Europe.**

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INCREASE IN COVID-19 CASES SPOOKS MARKETS

U.S. Treasury yields fell modestly last week across the curve, led by longer maturities.[1] The entirety of the decline occurred on Wednesday and Friday, with the latter move being the larger. Markets appeared to focus on concerns about increasing COVID-19 cases, although tariff worries also reemerged. U.S. virus cases hit a record high and several states were forced to restrict activities again, stoking fears of another lock down and an associated economic fallout. The decline in yields was little affected by over $150 billion in Treasury supply and generally stronger domestic economic data. Although the 30-year Treasury led the decrease in rates, the 5-year Treasury yield closed at an all-time record low on Friday.[1]

All non-Treasury sectors, except taxable municipals, underperformed Treasuries.[1] The securitized sectors outperformed other non-Treasury, taxable U.S. sectors. Asset-backed securities, commercial mortgage-backed and mortgage-backed securities only slightly underperformed Treasuries when adjusted for duration.[1] The highest-risk sectors gave back a portion of their recent outperformance and suffered the worst returns, with several experiencing negative weekly total returns.[1] High yield corporates endured the worst performance, followed by senior loans, preferred securities and investment grade corporates, all of which posted negative returns.[1] The global aggregate index delivered a modestly positive total return, as negative returns in the Asia Pacific region were more than offset by solidly positive returns in Europe.

MUNICIPAL NET DEMAND EXPECTED TO OUTSTRIP ISSUANCE

Municipal bond yields were range bound last week.[1] The new issue calendar of $9.5 billion was readily absorbed.[2] Weekly fund flows were positive for the sixth straight week at $1.5 billion.[3] This week's new issue calendar is expected to be $7.4 billion.[2]

The high grade municipal market has a very good tone. Performance has been so good that the market has experienced some "buyers' strike" at these low absolute levels. However, crossover buyers continue to find relative value in high grade municipals. We expect high grade municipals to be well bid and quiet through the remainder of the summer, with net demand expected to outstrip new issuance by $52 billion.[4]

Commonwealth of Massachusetts issued $954 million general obligation bonds (rated Aa1/AA).[5] This deal is a good example of relative value for crossover buyers. The 10-year bond was priced at a yield of 1.24%, substantially higher than the 0.70% yield offered on the taxable U.S. government counterpart The $456 million taxable component of the deal was also well received.

High yield municipals lag high grades, but their recovery continues.[1] Inflows remain positive, and credit spreads continue to contract.[1,3] Yields across fixed income markets are so low that investors are accepting more risk to pick up additional return, which is pushing them into such areas as high yield municipals. We believe high yield municipals should also remain well bid.

We expect high grade municipals to be well bid and quiet through the remainder of the summer.

HIGH YIELD CORPORATES LAND WITH A THUD AS SENTIMENT SEE-SAWS TO RISK OFF

High yield corporate bonds finished at the bottom of the fixed income pack for the second time in the past three weeks.[1] The asset class has swung between weekly extremes in June – from strong first- or second-place gains to sizable losses. Last week, high yield spreads widened by 36 bps and fund flows were negative for the first time since late March.[1] Despite the recent volatility, high yield has delivered the best results (+10.56%) for the second quarter.[1]

Investment grade corporates suffered their first negative return since early May.[1] The drop was slight (-0.07%), as spreads widened by only 7 bps during the week, to 153 bps – still below their 20-year average of 158 bps.[1] Market technicals remained healthy, with inflows of $7.6 billion.[3] Trading volume in investment grade bonds was light, typical for a summer week. We expect this July 4 holiday-shortened week to be relatively quiet as well.

High yield corporates have delivered the best results for the second quarter.

Emerging markets (EM) debt has recorded positive results for nine consecutive weeks and 12 of the last 14.[1] That said, June's performance to date (+2.56%) is lower than May's (+4.61%), as risk appetites have waned amid a recent resurgence in COVID-19 cases, particularly in the U.S.[1] Within EM, corporates modestly outperformed sovereigns last week, and local-currency markets posted a loss in the face of renewed U.S. dollar strength.[1] Flows into EM funds were negligible at $118 million.[3]

In focus

U.S. banks prove resilient

On 25 June, the Fed released the results of the Dodd-Frank Stress Test (DFAST) for the largest 33 U.S. banks. This year's tests also included a series of sensitivity analyses to better reflect the fallout from the coronavirus pandemic. This analysis incorporated more dire assumptions than the DFAST scenario, reflecting three different potential outcomes for the shape of the recovery: V, U or W.

All banks passed the DFAST and sensitivity scenarios, once again demonstrating the strength and resiliency of the U.S. bank sector. However, in light of the uncertainty regarding fallout from the coronavirus pandemic, the Fed took steps to limit the return of capital to common shareholders. This included a ban on share repurchases and limits on future common dividends.

In our opinion, the test results and the Fed's actions were marginally positive for preferred security and debt investors. Suspending share buybacks and limiting common dividends should shield preferred securities by retaining more loss-absorbing common equity capital.

We also believe the preferred dividends remain secure, since issuers must pay distributions on preferred securities if any dividend is paid to a common shareholder. While a handful of banks may need to trim common dividends, none are expected to suspend them.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.17	-0.02	0.00	-1.40
5-year	0.30	-0.02	0.00	-1.39
10-year	0.64	-0.05	-0.01	-1.28
30-year	1.37	-0.09	-0.04	-1.02

Source: Bloomberg L.P. As of 26 Jun 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	Month-to-date	Year-to-date
2-year	0.27	0.00	0.11	-0.77
5-year	0.41	0.00	0.03	-0.68
10-year	0.90	0.02	0.06	-0.54
30-year	1.63	0.00	-0.02	-0.46

Source: Bloomberg L.P. As of 26 Jun 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	141
30-year AAA Municipal vs Treasury	119
High Yield Municipal vs High Yield Corporate	72

Source: Bloomberg L.P., Thompson Reuters. As of 26 Jun 2020. AAA municipals represented by the MMD scale. The high yield ratio equals the yield-to-worst for the Bloomberg Barclays High Yield Municipal Index divided by the yield-to-worst for the Bloomberg Barclays High Yield Corporate Index. **Past performance is no guarantee of future results.**

Characteristics and returns

				Returns (%)		
Index	Yield to Worst (%)	Spread (bps)	Effective Duration (years)	Week	Month-to-date	Year-to-date
Municipal	1.51	–	5.40	0.14	0.78	2.03
High Yield Municipal	4.90	347[6]	9.43	0.38	3.84	-2.76
Short Duration High Yield Municipal[7]	4.34	368	4.07	0.15	2.09	-1.42
Taxable Municipal	2.39	160[8]	10.06	1.21	3.21	7.39
U.S. Aggregate Bond	1.27	69[8]	6.05	0.21	0.63	6.14
U.S. Treasury	0.50	–	7.18	0.51	0.23	8.86
U.S. Government Related	1.26	80[8]	5.99	0.36	0.85	3.86
U.S. Corporate Investment Grade	2.17	153[8]	8.53	-0.07	1.85	4.91
U.S. Mortgage-Backed Securities	1.38	72[8]	2.10	0.03	-0.14	3.45
U.S. Commercial Mortgage-Backed Securities	1.74	135[8]	5.32	0.24	1.47	5.04
U.S. Asset-Backed Securities	0.87	69[8]	2.12	0.11	1.02	3.28
Preferred Securities	4.28	308[8]	4.57	-0.54	0.29	-2.54
High Yield 2% Issuer Capped	6.79	616[8]	3.87	-1.15	1.35	-3.46
Senior Loans[9]	7.15	689	0.25	-0.78	1.61	-4.51
Global Emerging Markets	4.64	407[8]	6.53	0.14	2.56	-0.36
Global Aggregate (unhedged)	0.95	59[8]	7.33	0.16	0.88	2.97

6 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **7** Data is a subset of the S&P Short Duration Municipal Yield Index that is below investment grade/nonrated. Spread is the yield difference between this subset and the subset rated AAA. **8** Option-adjusted spread to Treasuries. **9** Spread refers to the 3-year discount margin. Duration is estimated based on the frequency of the reset date.

Source: Bloomberg L.P. and Credit Suisse. As of 26 Jun 2020. **Past performance is no guarantee of future results.** Unless otherwise noted, the index is Bloomberg Barclays. All index returns are shown in U.S. dollars. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer actually defaulting. **Effective duration** (expressed in years) measures the price sensitivity of a fixed-income investment to a change in interest rates, considering that expected cash flows will fluctuate as interest rates change. Index performance is shown for illustrative purposes only. Index returns include reinvestment of income and do not reflect investment advisory and other fees that would reduce performance in an actual client account. All indexes are unmanaged and unavailable for direct investment.

For more information, please visit nuveen.com.

1 Bloomberg L.P. **2** The Bond Buyer, 26 Jun 2020. **3** Lipper Fund Flows. **4** Citigroup. **5** Market Insight, MMA Research, 24 Jun 2020.

Any reference to credit ratings refers to the highest rating given by one of the following national rating agencies: S&P, Moody's or Fitch. 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.

Bloomberg Barclays Municipal Index covers the USD-denominated tax-exempt bond market. **Bloomberg Barclays High Yield Municipal Index** covers the USD-denominated, below investment grade tax-exempt bond market. **S&P Short Duration Municipal Yield Index** tracks the municipal bond market with maturities from 1 to 12 years. **Bloomberg Barclays Taxable Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term taxable bond market. **Bloomberg Barclays U.S. Aggregate Bond Index** covers the U.S. investment grade fixed rate bond market. **Bloomberg Barclays U.S. Treasury Index** includes public obligations of the U.S. Treasury. **Bloomberg Barclays U.S. Government-Related Index** includes debt guaranteed, owned and sponsored by the U.S. government; it does not include debt directly issued by the U.S. government. **Bloomberg Barclays U.S. Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable corporate bond market. **Bloomberg Barclays U.S. Mortgage-Backed Securities Index** is the MBS component of the U.S. Aggregate index and includes the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bloomberg Barclays CMBS ERISA-Eligible Index** is the CMBS component of the U.S. Aggregate index and includes CMBS investment grade securities that are ERISA eligible under the underwriter's exemption. **Bloomberg Barclays Asset-Backed Securities Index** is the ABS component of the U.S. Aggregate index and includes credit and charge cards, autos and utilities. **ICE BofA Merrill Lynch U.S. All Capital Securities Index** is a subset of the BofA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities. **Bloomberg Barclays High Yield 2% Issuer Capped Index** measures the market of USD-denominated, non-investment grade bonds and limits each issue to 2% of the index. The **Credit Suisse Leveraged Loan Index** is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. Loans are added to the index if they qualify according to the following criteria: The highest Moody's/S&P ratings are Ba1/BBB+, only funded term loans are included, and the tenor must be at least one year. **Bloomberg Barclays Emerging Market USD Aggregate Index** is a flagship hard currency Emerging Markets debt benchmark that includes USD denominated debt from sovereign, quasi-sovereign, and corporate EM issuers. **Bloomberg Barclays Global Aggregate Unhedged Index** measures the performance of global bonds. It includes government, securitized and corporate sectors and does not hedge currency. One **basis point** equals .01%, or 100 basis points equal 1%.

A word on risk

Investing involves risk; principal loss is possible. Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Below investment grade or high yield debt securities are subject to liquidity risk and heightened credit risk. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Foreign investments involve additional risks, including currency fluctuation, political and economic instability, lack of liquidity and differing legal and accounting standards. Asset-backed and mortgage-backed securities are subject to additional risks such as prepayment risk, liquidity risk, default risk and adverse economic developments. The value of convertible securities may decline in response to such factors as rising interest rates and fluctuations in the market price of the underlying securities. Senior loans are subject to loan settlement risk due to the lack of established settlement standards or remedies for failure to settle. These investments are subject to credit risk and potentially limited liquidity, as well as interest rate risk, currency risk, prepayment and extension risk, and inflation risk

Investors should contact a tax advisor regarding the suitability of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

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