nuveen
A TIAA Company

Weekly Fixed Income Commentary

27 July 2020

Long Treasury yields decline, but risk assets fare well

Long U.S. Treasury yields fell last week, while short yields held steady.[1] At the same time, risk assets remained well-supported due to strong demand from the Federal Reserve (Fed), U.S. and non-U.S. investors, and banks. Disappointing economic data and rising U.S./China tensions did little to slow the buying of U.S. Treasuries. The Fed is not expected to act at its July meeting this week.

HIGHLIGHTS

- **The highest-risk sectors performed best, led by high yield corporates and preferred securities.**
- **High grade and high yield municipals continued to rally.**
- **The global aggregate sector return was boosted by strong performance in Europe.**

Bill Martin
Head of Global Fixed Income

John Miller
Head of Municipals

LONG TREASURY YIELDS FALL, SHORT RATES REMAIN STABLE

U.S. Treasury yields declined last week for all maturities longer than two years.[1] Short maturities were little changed throughout the week, with the 2-year Treasury yield closing within 1 basis point (bps) of its opening level each day.[1] Longer maturities declined steadily, and the 30-year yield moved lower each day.[1] However, falling interest rates did not indicate a broad risk-off market sentiment. Yields fell and gold appreciated – generally associated with a cautious market tone – but risk assets were also well-supported. Strong demand from the Federal Reserve, U.S. and non-U.S. investors, and banks have helped both Treasuries and non-Treasury sectors. Disappointing economic data and rising U.S./China tensions did little to slow the buying, and the 5-year Treasury yield hit an all-time low on Tuesday.[1]

Risk assets fared well last week, with most sectors outperforming Treasuries.[1] The highest-risk sectors performed best. High yield corporates led the way, followed by preferred securities.[1] Last week's positive total return gave the preferred securities sector a positive total return for the year.[1] Only senior loans and high yield corporates have negative total returns for the year, although high yield is now only slightly negative.[1] The securitized sectors experienced the lowest returns last week.[1] Asset-backed, commercial mortgage backed, and mortgage-backed securities (MBS) all posted lower returns than Treasuries.[1] Only MBS suffered a negative total return for the week.[1] The global markets delivered strong returns, with both emerging and developed regions posting weekly returns above 1%.[1] The global aggregate sector return was boosted by strong performance in Europe.[1]

The preferred securities sector now has a positive total return for the year.

HIGH YIELD MUNICIPALS RALLY AS INVESTORS SEEK MORE YIELD

Municipal bond prices continued to rise last week, along with U.S. Treasuries.[1] New issue supply totaled $7.6 billion and was well received.[2] Fund flows were positive for the eleventh consecutive week at $2.1 billion.[3] This week's new issue supply is expected to be $8 billion ($3 billion taxable).[2]

High grade municipal bond prices have been rising for weeks, with most maturities up to 10 years offering their lowest yields in history.[1] The 10-year bond is yielding a record low 0.71%[1] The 30-year bond yields 1.43%, a mere 5 bps cheaper than its historic low of 1.38%[1] However, municipal bonds continue to look cheap compared to their U.S. Treasury counterparts, with the 10- and 30-year Treasury bonds yielding 0.58 % and 1.23% respectively.

The state of Maryland sold four general obligation deals totaling more than $1.0 billion, including $345 million taxable (rated AAA/AAA).[4] Maryland is one of the strongest trading credits in the market, and four different tranches were bought competitively by four different dealers. Underwriters do not appear concerned about the bonds that remain outstanding because of the relative value of the deals.

High yield tax-exempt bonds continue to grind richer, as investors are forced to branch out into lower-rated bonds to pick up extra yield.[1] We expect the high yield rally to continue, with yields substantially cheaper than high grade. Fund flows remain positive and accelerated to nearly a $400 million pace last week.[3] Credit spreads continue to contract on average, and new issuance deals are heavily oversubscribed.[1,2] While more rational pricing of credit risk continues to take hold, further credit spread tightening will require more time and information to resolve uncertainty in revenue disruptions.

HIGH YIELD CORPORATES REPEAT THEIR FIRST-PLACE FINISH AS SPREADS TIGHTEN FURTHER

High yield corporate bonds took the top spot among fixed income sectors for the second week running, posting their best returns since early June.[1] Despite some trepidation around a resurgent coronavirus and deteriorating U.S./China relations, the high yield market traded firmly amid strong supply/demand technicals, including healthy inflows ($3.9 billion) and relatively muted new issuance ($2 billion).[1,2,3] Spreads tightened by 52 bps, to 505 bps, and are now below their 20-year average.[1] Higher-quality (BB and B) bonds modestly outperformed CCC credits.[1]

Investment grade corporates extended their string of gains to four weeks and 10 of the last 11.[1] With light summer trading, reduced dealer inventories and new investment grade supply of just $6.6 billion, the week's $7.6 billion of flows into the asset class caused spreads to tighten and yields to dip to a record-low 1.90%.[1,2,3] Last week marked the first time since 2009 that supply volume was lower than inflows. New issuance is likely to remain quiet through Labor Day.

High yield corporate spreads are now below their 20-year average.

Emerging markets (EM) debt posted positive returns for the thirteenth consecutive week.[1] Spreads narrowed by 13 bps as optimism around last week's announcement of an EU relief package and the prospect of another round of U.S. stimulus overshadowed heightened U.S./China friction.[1] All EM segments gained ground, but local-currency markets outperformed hard-currency sovereigns and corporates as the U.S. dollar weakened.

In focus

The EU strikes a deal to combat coronavirus

After months of delays and recent tense negotiations, the European Union's (EU) 27 member states agreed to a €750 billion ($870 billion) relief package to fight the devastating economic effects of the coronavirus pandemic. In its latest forecast, the EU projected GDP for the region will contract by 8.3% in 2020.

The EU's executive branch will pay for the program by issuing bonds with maturities ranging from 3 to 30 years. Debt repayment will come from the EU's budget, meaning countries that contribute the most, like Germany and France, will be shouldering more of the financial burden.

The plan has two components. Under the first part, about €390 billion in grants that do not need to be repaid will be distributed to the hardest-hit countries. Italy and Spain will be among the largest beneficiaries, receiving around €80 billion and €70 billion, respectively. The second component, representing roughly €360 billion, will be made available as low-interest loans.

Market reaction to the announcement was notable. Italian and Spanish government bonds rallied, with 7-10 year yields falling to their lowest levels since before the coronavirus outbreak, and the euro strengthening by 2% versus the U.S. dollar. The European Parliament still must approve both the stimulus package and the EU's €1.1 trillion budget to which it's attached.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.15	0.00	0.00	-1.42
5-year	0.28	-0.01	-0.01	-1.42
10-year	0.59	-0.04	-0.07	-1.33
30-year	1.23	-0.10	-0.18	-1.16

Source: Bloomberg L.P. As of 24 Jul 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	0.15	-0.02	-0.12	-0.89
5-year	0.29	-0.02	-0.12	-0.80
10-year	0.71	-0.04	-0.19	-0.73
30-year	1.43	-0.04	-0.20	-0.66

Source: Bloomberg L.P. As of 24 Jul 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	120
30-year AAA Municipal vs Treasury	116
High Yield Municipal vs High Yield Corporate	82

Source: Bloomberg L.P., Thompson Reuters. As of 24 Jul 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	1.27	–	5.21	0.38	1.32	3.43
High Yield Municipal	4.58	335[5]	8.71	0.46	2.15	-0.55
Short Duration High Yield Municipal[6]	4.19	369	3.97	0.29	0.41	-0.43
Taxable Municipal	2.23	151[7]	10.09	0.76	1.85	9.12
U.S. Aggregate Bond	1.15	62[7]	6.16	0.41	1.19	7.40
U.S. Treasury	0.46	–	7.27	0.41	0.79	9.58
U.S. Government Related	1.15	73[7]	6.08	0.45	1.15	5.05
U.S. Corporate Investment Grade	1.90	131[7]	8.79	0.95	3.03	8.20
U.S. Mortgage-Backed Securities	1.29	70[7]	1.98	-0.14	-0.08	3.42
U.S. Commercial Mortgage-Backed Securities	1.57	121[7]	5.32	0.31	0.87	6.10
U.S. Asset-Backed Securities	0.77	62[7]	2.14	0.12	0.27	3.60
Preferred Securities	3.38	248[7]	4.33	1.35	3.01	0.28
High Yield 2% Issuer Capped	5.58	505[7]	3.56	1.55	3.80	-0.18
Senior Loans[8]	6.48	626	0.25	0.69	1.88	-2.96
Global Emerging Markets	4.32	380[7]	6.67	1.06	2.45	2.01
Global Aggregate (unhedged)	0.87	53[7]	7.38	1.14	2.24	5.29

5 Yield difference between the Bloomberg Barclays High Yield Municipal Index and the 20-year AAA MMD scale. **6** 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. **7** Option-adjusted spread to Treasuries. **8** 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 24 Jul 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, 24 Jul 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 22 Jul 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%.