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Weekly Fixed Income Commentary

3 August 2020

Multiple Treasury yields hit all-time lows

U.S. Treasury yields fell again last week, with the 2-, 5- and 10-year yields reaching record lows. Investors appeared to be concerned about negotiations over additional fiscal stimulus and a rise in coronavirus cases. The Federal Reserve (Fed) kept rates steady at its July meeting, but is taking stock of its approach to monetary policy.

HIGHLIGHTS

- **Preferred securities delivered the highest returns, followed by high yield corporates.**
- **High grade municipal bond prices rallied again.**
- **Emerging markets debt extended its winning streak to 14 weeks.**

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TREASURY YIELDS FALL TO RECORD LOWS

U.S. Treasury yields fell again last week, with several maturities hitting all-time lows.[1] Strong economic data and soft Treasury auctions pushed rates higher to begin the week.[1] But the move did not persist, and yields fell steadily throughout the remainder of the week.[1] Investors appeared to be concerned about ongoing negotiations in Washington for an additional fiscal stimulus package. The Fed statement mentioned the continued rise in virus cases and noted that the path of economic recovery would depend on the course of the virus. The subsequent decline in rates was led by intermediate maturities, with the 2-, 5- and 10-year Treasury yields all closing at record lows.[1]

Risk sentiment ebbed and flowed last week, following the outlook for more fiscal support. All non-Treasury sectors produced positive total returns, except senior loans remained unchanged.[1] Several sectors outpaced Treasuries. Preferred securities delivered the highest returns, followed by high yield corporates.[1] The flat return of senior loans was the weakest non-Treasury performance, but asset-backed securities and investment grade corporates also underperformed Treasuries.[1] July was strong for risk assets, with positive total returns across the board. Only senior loans are suffering a negative total return for the year.[1] The global aggregate sector enjoyed another strong week, as the European region returned more than 2% for the second consecutive week.[1]

HIGH GRADE MUNI TAX-EXEMPT YIELDS MARK ALL-TIME LOWS

Municipal bond prices rallied again last week, along with Treasuries, and both markets ended with firm tones.[1] Municipal new issuance totaled $8 billion and was well received.[2] Fund flows were positive for the 12th consecutive week at $1.8 billion.[3] This week's new issuance is expected to be $7.4 billion ($3.2 billion taxable).[2] It should be well received.

High grade municipal tax-exempt yields continued to mark new all-time lows on the shorter part of the yield curve, and long yields are close to their lows.[1] The highest quality municipal bonds are now essentially considered a vehicle to store value. With rates so low, it is difficult mathematically to see high grade municipal bonds as a total return investment. We believe mid-grade and high yield municipals are still mispriced with room to run.

The cities of Dallas and Fort Worth issued $1.2 billion taxable revenue bonds for DFW International Airport (rated A1/A).[4] The deal was well received, and bonds were trading 15 basis points (bps) richer in the secondary market from where they were issued. Taxable deals are just as popular as tax-exempt deals in this ultra-low interest rate environment.

High yield municipal investors added $181.3 million in fund flows last week, for 11 consecutive weeks of positive flows.[3] This strong demand should keep downward pressure on elevated credit spreads. Flows are favoring longer duration strategies. Short duration high yield municipal credit spreads are 36 bps wider on average, as reflecting a meaningful inversion in the credit spread curve.[1] New issuance this week is expected to consist of a handful of smaller land development deals, keeping investors focused on the secondary market. Defaults this year have been highly concentrated so far this year in the senior living space.

July was strong for risk assets, with positive total returns across the board.

HIGH YIELD CORPORATE BONDS TURN POSITIVE FOR THE YEAR

High yield corporates gained for the fifth week in a row.[1] Their year-to-date return turned positive after months of clawing back from a low of nearly -20% in late March.[1] Spreads tightened by 15 bps last week, finishing under 500 bps for the first time since early March.[1] Even after rallying, high yield remains attractive to income-seeking investors because it offers significant spreads at a time when global rates are near year-to-date lows.[1]

Investment grade corporate bonds recorded their smallest rise in six weeks and their second-lowest return since early May.[1] For July and this year, however, the asset class is among the top-performing fixed income categories, benefiting from a drop in new supply and steady or increasing demand ($6.1 billion of inflows last week).[3] The average yield on investment grade credit ended the week at 1.86%, a new all-time low, and spreads stayed well below their 20-year average.[1]

Investment grade corporates are among the top-performing fixed income categories for the year.

Emerging markets (EM) debt extended its winning streak to 14 weeks.[1] The asset class hasn't posted a negative weekly return since late April. Support came from the Fed's continued dovishness, which encouraged a bid for EM debt and other risk assets. Spreads narrowed modestly, and fund flows were slightly positive.[1,3] Within EM, sovereign debt outperformed corporate bonds and local-currency issues.

In focus

No surprises from the Fed

As expected, the Fed made no major policy announcements at its July meeting last week. Chair Jerome Powell and his colleagues kept the fed funds target rate in the 0% - 0.25% range, where it has been since March. It will likely remain there for some time.

The Fed indicated it will stand pat on rates until it is "confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." In our view, that means until at least 2022 under the best of circumstances — and that assumes the development of a successful coronavirus vaccine.

In addition, Powell briefly referred to the Fed's ongoing wholesale review of its monetary policy framework. The Fed routinely takes stock of its approach to monetary policy, and we expect a few significant changes starting later this year.

First, the Fed will likely consider its 2% inflation target in a more symmetrical manner. This would mean allowing inflation to exceed that threshold when the economy is operating at full capacity to offset unavoidably low inflation during downturns like the current one.

Second, the Fed's forward guidance might become more specific and outcome-focused, using words like "until" and "unless," along with concrete unemployment, inflation or other economic targets that must be achieved before policy is modified.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	July 2020	Year-to-date
2-year	0.11	-0.04	-0.04	-1.46
5-year	0.21	-0.07	-0.08	-1.49
10-year	0.53	-0.06	-0.13	-1.39
30-year	1.19	-0.04	-0.22	-1.20

Source: Bloomberg L.P. As of 31 Jul 2020. **Past performance is no guarantee of future results.**

Municipal market

		Change (%)		
Maturity	Yield to Worst	Week	July 2020	Year-to-date
2-year	0.13	-0.02	-0.14	-0.91
5-year	0.23	-0.06	-0.18	-0.86
10-year	0.65	-0.06	-0.25	-0.79
30-year	1.37	-0.06	-0.26	-0.72

Source: Bloomberg L.P. As of 31 Jul 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	118
30-year AAA Municipal vs Treasury	114
High Yield Municipal vs High Yield Corporate	84

Source: Bloomberg L.P., Thompson Reuters. As of 31 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	July 2020	Year-to-date
Municipal	1.20	–	5.18	0.36	1.68	3.80
High Yield Municipal	4.53	336[5]	8.53	0.55	2.72	0.00
Short Duration High Yield Municipal[6]	4.16	373	3.95	0.21	1.06	-0.22
Taxable Municipal	2.16	150[7]	10.11	0.61	2.47	9.79
U.S. Aggregate Bond	1.05	60[7]	6.09	0.30	1.49	7.72
U.S. Treasury	0.41	–	7.28	0.35	1.14	9.96
U.S. Government Related	1.09	71[7]	6.11	0.54	1.70	5.61
U.S. Corporate Investment Grade	1.86	133[7]	8.79	0.22	3.25	8.44
U.S. Mortgage-Backed Securities	1.07	58[7]	1.68	0.26	0.18	3.69
U.S. Commercial Mortgage-Backed Securities	1.51	120[7]	5.34	0.34	1.22	6.47
U.S. Asset-Backed Securities	0.71	60[7]	2.14	0.15	0.42	3.75
Preferred Securities	3.09	225[7]	4.23	1.03	4.08	1.32
High Yield 2% Issuer Capped	5.39	490[7]	3.52	0.82	4.66	0.64
Senior Loans[8]	6.50	629	0.25	0.00	1.88	-2.97
Global Emerging Markets	4.23	376[7]	6.73	0.66	3.12	2.68
Global Aggregate (unhedged)	0.82	52[7]	7.37	0.93	3.19	6.27

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 31 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, 31 Jul 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 29 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%.

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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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GCM-1289795PR-W0820P