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Weekly Fixed Income Commentary

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Treasury refunding plans boost yields

U.S. Treasury yields moved higher last week, led by longer maturities. Quarterly Treasury refunding announcements fueled the increase, and Friday's stronger-than-expected employment report helped solidify the rise. The yield curve steepened as a result.

HIGHLIGHTS

- **Emerging markets performed best, followed by high yield corporates, senior loans, investment grade corporates and preferred securities.**
- **High grade municipal bond yields continued to grind lower.**
- **The global aggregate sector endured a negative total return, dragged down by Europe.**

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LOOMING TREASURY ISSUANCE LIFTS RATES

U.S. Treasury yields moved higher last week for all maturities, with longer maturities leading rate movements every day.[1] The increase was fueled by the quarterly Treasury refunding announcements mid-week. Monthly coupon auctions should increase by $24 billion beginning this month, although no increase in TIPS auctions was forecast. Within the announcement, the Treasury forecasts an additional $1 trillion of borrowing needs to fund an expected fiscal stimulus bill. Given the uncertainty over negotiations for another virus-related stimulus bill, this estimate is subject to considerable variability. Friday's stronger-than-expected July employment report helped solidify the yield increase, and the yield curve steepened as a result.

Investor sentiment improved last week, and all sectors outperformed Treasuries.[1] Emerging markets posted the strongest return at nearly 1%.[1] High yield corporates, senior loans, investment grade corporates and preferred securities also delivered solid returns.[1] Commercial mortgage-backed securities (CMBS) were the only U.S. sector to suffer a negative total return for the week, although even CMBS outperformed similar-duration Treasuries.[1] The global aggregate sector endured a negative weekly total return, dragged down by the European region.[1]

MUNICIPAL SUPPLY NOT KEEPING UP WITH DEMAND

Municipal bond yields continued to grind lower for yet another week.[1] New issue supply was only $8.1 billion and was readily absorbed.[2] Fund flows were positive for the 13th consecutive week at $1.6 billion.[3] This week's new issuance is expected to be $8.4 (2.9 billion taxable).[2]

The supply of municipal bonds is simply not enough to meet the ongoing demand. Thus, a portion of the tax-exempt high grade municipal yield curve hit another all-time low. Friday's jobs number, although constructive, did nothing to deter opinions that rates will remain low for the foreseeable future.

Long Island Power Authority (LIPA) issued $507 million electric revenue bonds (rated A2/A).[4] The 10-year bond was priced with a 5% coupon at a yield of 0.97%. By week's end, this maturity traded in the secondary market at 0.86%. With the 10-year U.S. Treasury bond yielding approximately 0.55%, the relative attractiveness to the LIPA issue looks clear, especially for New York residents seeking tax-exempt income.

High yield municipal bonds fund flows were positive for the 12th consecutive week, with a clear bias toward longer-duration strategies.[3] As a result, the credit spread difference between short- and long-duration high yield municipals has increased to 44 basis points (bps).[1] The credit spread curve has not seen such a significant inversion in several years. This week's new issue calendar is expected to be heavier, headlined by larger industrial development deals from COVANT and Marathon Oil.[4] The economically sensitive industrial development sector has lagged to the overall recovery, so we expect these bonds to be relatively cheap.

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EMERGING MARKETS DEBT IS THE WEEK'S TOP PERFORMER

Emerging markets (EM) debt gained for the 15th consecutive week.[1] The asset class has posted only two negative weekly returns since April.[1] Spreads narrowed by 13 bps last week, and are now nearly 50% below their pandemic peak of 720 bps.[1] Fund flows were modestly positive.[3] Within EM, sovereign debt outperformed corporate bonds and local-currency issues. Many EM currencies struggled against the U.S. dollar, which strengthened after six weeks of declines. The Turkish lira hit a record low versus the dollar.

High yield corporate bonds remained in the winning column.[1] Last week's nearly 1% increase brought high yield's total return for the quarter to 5.2%, leading all fixed income sectors.[1] Spreads tightened by 10 bps to end the week at 480 bps, 50 bps below their long-term average.[1] Fund inflows approached $4.5 billion, their highest weekly total since mid-June.[3] Amid last week's risk-on sentiment, lower-quality (CCC) issues outperformed higher-rated (B and BB) credits.[1]

The average yield on investment grade corporate bonds continued to drop, ending the week at another all-time low.

Investment grade corporates lagged their high yield counterparts, but still delivered positive results for the sixth week in a row and 12 of the last 13.[1] The average yield on investment grade corporate bonds continued to drop, ending the week at 1.82%, another all-time low.[1] Spreads narrowed by 7 bps and are now more than 30 bps lower than their 20-year average.[1]

In focus

Fed buoys agency MBS

Despite this year's volatile markets, the agency mortgage-backed securities (MBS) sector has enjoyed positive total returns most months, with a slightly negative return in July. Relative returns have been less consistent. The sector outperformed based on Fed support and then lagged in the subsequent risk-asset recovery during the second quarter.

We believe the agency MBS sector will continue to thrive. The Fed increased its MBS purchases in mid-March and has since bought more than $900 billion, with plans to continue.[5] Fed holdings have also increased by about $567 billion since mid-March.[5]

U.S. Treasury yields, agency MBS prices and the refinance index imply a significant increase in mortgage prepayments. Refinancing activity remains high, and should accelerate. We expect the Fed and other investors will easily absorb the supply. While the full impact of the coronavirus crisis on borrower behavior is still unknown, data suggest that worst-case scenarios for mortgage defaults and losses are unlikely.

Fed buying is driving generic MBS valuations higher and pushing investors into specified agency pools and AAA-rated non-agency bonds. Although agency MBS appear fully valued, we believe they offer an attractive combination of credit and spread opportunity compared to U.S. Treasuries. We also find value in investment grade securities backed by non-qualified mortgage loans. We favor seasoned credit risk transfer (CRT) securities for their combination of excess spread and lower delinquency levels.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.13	0.02	0.02	-1.44
5-year	0.23	0.03	0.03	-1.46
10-year	0.57	0.04	0.04	-1.35
30-year	1.24	0.04	0.04	-1.16

Source: Bloomberg L.P. As of 7 Aug 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	0.09	-0.04	-0.04	-0.95
5-year	0.16	-0.07	-0.07	-0.93
10-year	0.58	-0.07	-0.07	-0.86
30-year	1.27	-0.10	-0.10	-0.82

Source: Bloomberg L.P. As of 7 Aug 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	102
30-year AAA Municipal vs Treasury	103
High Yield Municipal vs High Yield Corporate	83

Source: Bloomberg L.P., Thompson Reuters. As of 7 Aug 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	1.13	–	5.14	0.47	0.47	4.28
High Yield Municipal	4.42	334[6]	8.06	0.75	0.75	0.75
Short Duration High Yield Municipal[7]	4.13	377	3.99	0.39	0.39	0.17
Taxable Municipal	2.15	145[8]	10.10	0.07	0.07	9.87
U.S. Aggregate Bond	1.03	55[8]	6.14	0.10	0.10	7.83
U.S. Treasury	0.43	–	7.40	-0.15	-0.15	9.79
U.S. Government Related	1.08	68[8]	6.17	0.27	0.27	5.90
U.S. Corporate Investment Grade	1.82	126[8]	8.86	0.39	0.39	8.86
U.S. Mortgage-Backed Securities	0.99	47[8]	1.63	0.14	0.14	3.83
U.S. Commercial Mortgage-Backed Securities	1.53	120[8]	5.34	-0.10	-0.10	6.36
U.S. Asset-Backed Securities	0.70	57[8]	2.13	0.03	0.03	3.79
Preferred Securities	3.18	234[8]	4.28	0.37	0.37	1.69
High Yield 2% Issuer Capped	5.33	480[8]	3.54	0.56	0.56	1.21
Senior Loans[9]	6.39	616	0.25	0.41	0.41	-2.57
Global Emerging Markets	4.13	363[8]	6.79	0.99	0.99	3.70
Global Aggregate (unhedged)	0.82	49[8]	7.39	-0.05	-0.05	6.21

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 7 Aug 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, 7 Aug 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 5 Aug 2020. **5** New York Federal Reserve.

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 appropriateness 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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