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Weekly Fixed Income Commentary

24 August 2020

Risk-off sentiment leads Treasury yields lower

U.S. Treasury yields fell steadily last week, led by longer maturities, and the yield curve flattened significantly. Wednesday's 20-year maturity auction overwhelmed investor demand and pushed yields briefly higher, but cautious attitudes prevailed and yields fell again in the following days.

HIGHLIGHTS

- **Taxable municipals and preferred securities outpaced Treasuries.**
- **Municipal yields rose for the second consecutive week.**
- **Emerging markets debt returns edged lower, posting a second consecutive weekly decline.**

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CAUTIOUS SENTIMENT DRIVES TREASURY RATES LOWER

U.S. Treasury yields fell steadily last week, led by longer maturities.[1] The yield curve flattened significantly, as the 30-year fell more than 10 basis points (bps) while the 2-year was nearly unchanged.[1] The move lower and flatter was persistent throughout the week with only a brief respite mid-week. On Wednesday, the Treasury auctioned $25 billion of the 20-year maturity, which struggled as ever-increasing issuance overwhelmed investor demand and pushed yields higher. Likewise, the Fed meeting minutes helped increase rates, as market participants were disappointed that the Fed appeared to show little support for new policies that would involve it buying longer-maturity Treasuries. However, Wednesday's increase in rates and steeper yield curve were more than offset, as yields continued their march lower the remainder of the week. Despite better-than-expected U.S. economic data, the risk-off sentiment persisted and the 30-year Treasury yield fell more than 8 bps the following days.[1]

The cautious market tone weighed on returns for non-Treasury sectors. Only taxable municipals and preferred securities outpaced Treasuries.[1] On a relative basis, commercial mortgage-backed and asset-backed securities performed well, as both joined preferred securities in outperforming similar-duration Treasuries. Emerging markets and mortgage-backed securities were the only sectors that suffered a negative weekly total return, although both returns moved barely into negative territory.[1] The global aggregate index performed roughly in line with U.S. markets, as stronger returns in the Asian region were offset by modestly softer returns in Europe.[1]

MUNICIPAL MARKET TECHNICALS REMAIN STRONG

Municipal yields rose last week for the second consecutive week.[1] New issuance of $13.5 billion was priced to sell and well received.[2] Fund flows remained positive for the 15th straight week, totaling $1.8 billion.[3] This week's new issue calendar is expected to be $10.9 billion ($5.1 taxable).[2] It should also be well received.

Despite rising yields, the market remains strong.[1] Yields hit all-time lows two weeks ago, causing some investors to reassess valuations.[1] The municipal market should experience a robust new issue calendar through the end of the year, and deals should be priced to sell. However, demand remains strong, and we would look at any yield selloff as a buying opportunity.

New York Metropolitan Transit Authority (MTA) attempted to issue $450 million of notes (rated A2/BBB+).[4] However, dramatically declining ridership has left lenders less than eager to lend the system money. The issuer accessed the Federal Reserve via the Municipal Liquidity Facility program. The total interest cost for the notes was 1.92%, 85 basis points lower than where public markets were willing to lend MTA money.

High yield municipal bond yields have proven resilient over the last two weeks, rising just 4 bps on average, versus U.S. Treasury yields increasing 6 bps to 10 bps and AAA-rated municipal yields up 15 bps to 19 bps.[1] As a result, the average high yield municipal credit spread has tightened by 15 bps.[1] High yield new issuance remains tepid, and the asset class continues to benefit from positive fund flows and heavy reinvestment flows. Defaults remain concentrated in isolated sectors where underwriting practices had been notably more aggressive in recent years.

The municipal market should experience a robust new issue calendar through the end of the year.

INVESTMENT GRADE CORPORATES PROVE RESILIENT

Investment grade corporate bonds rebounded from the prior week's sharp loss, finishing with a modestly positive return.[1] Spreads widened incrementally for the second week in a row, but have narrowed slightly (-2 bps) since the beginning of the month and remain well below their 20-year average.[1] This resilience is noteworthy given a surge in supply ($115+ billion) during August, normally a quieter period for new issuance.[2]

High yield corporates eked out a gain last week, an improvement over the week before but still near the bottom of the pack.[1] The asset class suffered its first week of negative fund flows (-$301 million) since early July.[3] Last week's outflows, however, were insignificant relative to total net inflows (+$63 billion) over the past five months.[3] For August to date, the high yield sector leaders are transportation, energy and chemicals.[1] On a quality basis, CCC bonds are outperforming their higher-quality (B and BB) counterparts.[1]

High yield corporates suffered their first week of negative fund flows since July.

Emerging markets (EM) debt edged lower, posting its second consecutive decline after a 15-week run of positive returns.[1] Spreads widened by 6 bps, although fund flows remained positive.[1,3] Within EM segments, corporate debt fared better than sovereign and local-currency issues.[1] Geopolitical tensions have driven recent volatility in the EM space, but country-specific factors are also having an impact as governments address fiscal challenges.

In focus

Corporate credit rally comes with a note of caution

The S&P 500 Index hit another record high last week, the latest milestone in what has been a sharp recovery for stocks amid ongoing pandemic-driven uncertainty. While corporate credit sectors have also rebounded impressively, their current valuations price in a higher level of risk than the equity market.

Senior loan prices have recouped 77% of losses sustained in February and March, and spreads have retraced 82% of their widening over that period.[1] For high yield bonds, the numbers are similar (83%) on both a price and spread basis.[1] Even within investment grade corporates, spreads have come in only 87% from their March wides.[1]

The recovery gap for corporate credit is notable not only relative to large cap growth stocks – this year's top-performing equity category –but also to out-of-favor areas like small caps and value shares. Small caps have clawed back roughly 93% from their February lows, and value stocks nearly 90%.[1]

In our view, even investors with no direct exposure to credit should pay attention to the disconnect between debt and equity markets. The bottom line is that corporate credit sectors are conveying a much more cautious tone than stocks. That should give pause to those who have ridden the equity wave higher but haven't necessarily considered what other asset classes may be saying about risk.

U.S. Treasury market

		Change (%)		
Maturity	Yield	Week	Month-to-date	Year-to-date
2-year	0.14	0.00	0.04	-1.43
5-year	0.27	-0.03	0.06	-1.43
10-year	0.63	-0.08	0.10	-1.29
30-year	1.34	-0.11	0.15	-1.05

Source: Bloomberg L.P. As of 21 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	0.14	0.00	0.01	-0.90
5-year	0.23	0.00	0.00	-0.86
10-year	0.73	0.07	0.08	-0.71
30-year	1.46	0.10	0.09	-0.63

Source: Bloomberg L.P. As of 21 Aug 2020. **Past performance is no guarantee of future results.**

Yield ratios

	Ratio (%)
10-year AAA Municipal vs Treasury	114
30-year AAA Municipal vs Treasury	108
High Yield Municipal vs High Yield Corporate	79

Source: Bloomberg L.P., Thompson Reuters. As of 21 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	1.25	–	5.25	-0.31	-0.14	3.65
High Yield Municipal	4.46	319[5]	8.39	-0.11	0.61	0.62
Short Duration High Yield Municipal[6]	4.14	371	4.01	0.09	0.57	0.35
Taxable Municipal	2.18	141[7]	10.10	0.69	-0.32	9.43
U.S. Aggregate Bond	1.13	58[7]	6.12	0.27	-0.54	7.14
U.S. Treasury	0.48	–	7.30	0.45	-0.73	9.15
U.S. Government Related	1.12	67[7]	6.07	0.20	-0.23	5.37
U.S. Corporate Investment Grade	1.93	131[7]	8.73	0.30	-0.90	7.46
U.S. Mortgage-Backed Securities	1.18	58[7]	1.87	-0.01	-0.01	3.68
U.S. Commercial Mortgage-Backed Securities	1.51	114[7]	5.32	0.40	0.04	6.51
U.S. Asset-Backed Securities	0.63	49[7]	2.12	0.17	0.17	3.93
Preferred Securities	2.95	214[7]	4.20	0.60	1.45	2.79
High Yield 2% Issuer Capped	5.63	502[7]	3.67	0.05	0.16	0.80
Senior Loans[8]	6.26	602	0.25	0.09	1.03	-1.96
Global Emerging Markets	4.17	361[7]	6.69	-0.04	0.60	3.29
Global Aggregate (unhedged)	0.87	49[7]	7.34	0.22	-0.41	5.83

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 21 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, 21 Aug 2020. **3** Lipper Fund Flows. **4** Market Insight, MMA Research, 19 Aug 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 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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GCM-1310955PR-W0820P